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Pensions & Investment Age

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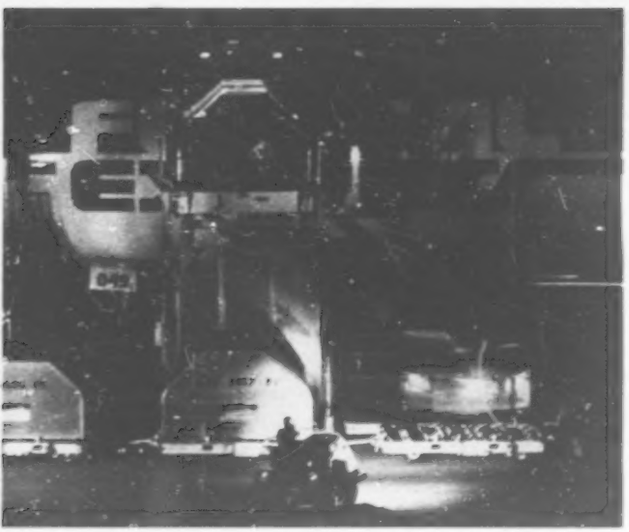

While tax reform may slow leasing deals, officials of Federal Express Aviation Services Inc. expect airline leasing to stay healthy.

Tax proposals fought

Leasing targeted

By Barry B. Burr

The fate of much of the equipment and plant leasing industry lies in the hands of Congress.

Without much success so far, lessors and their lobbyists are fighting sweeping tax proposals in the Senate and House that likely would end many lucrative investment tax benefits and raise the cost of new capital investment.

The pending bills threaten leasing generally by ending the investment tax credit, which essentially amounts to an immediate government subsidy of 10% of the value of new plants or equipment.

In addition, the bills would impose a minimum tax on profitable companies, preventing them from sheltering a large part their earnings from taxes by tightening depreciating and other investment incentive tax benefits. General Electric Co., whose General Electric Credit Corp. is a major lessor, has been the most publicized user of such legal sheltering.

The bills also would slow down depreciation.

According to leasing industry executives, the pending legislation is having the most impact on leasing volume this year.

They say the outlook for their industry depends on the proposed tax changes more [illegible] on any other capital investment incentive, including the general drop in the cost of capital caused by declining interest rates and falling inflation or the demand for new equipment due to industrial modernization and restructuring programs.

"We stand in a situation where, at a stroke of a pen, Congress could cause leasing to expand dramatically or shrink dramatically," said Richard A. Sun, vice president, First Boston Corp., New York.

Satellite leasing, in particular, which had peaked and was declining, will be at a standstill because of the loss of the space shuttle Challenger.

The outlook for using the only alternative launch vehicle, the unmanned Ariane rocket, from French Guiana appears little more promising because of difficulty with refitting satellites designed for shuttle-ferried orbiting and problems with launchings. One Ariane rocket was destroyed shortly after liftoff last year. It was carrying a GTE Corp.-leased satellite.

GTE launched another satellite with Ariane in March, and is scheduled to launch two others; all three, however, are owned outright.

Leasing could pick up for foreign-owned plants as more are built in the United States. Mazda Motor Corp. is arranging some $500 million in financing to lease its automobile plant in Flat Rock, Mich.

Foreign units generally tend to have, initially, low earnings and are unable to use all their investment tax benefits.

They can lower their capital financing costs by leasing.

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IBM gooses earnings

Accounting changes add millions; more considered

By Richard J. Gillespie

ARMONK, N.Y. — IBM Corp. has adopted less conservative accounting policies in the past three years — possibly to enhance its level of earnings — and is considering early adoption of Financial Accounting Standards Board Statement 87 on the reporting of pension liabilities.

The early adoption of FASB 87 would enhance IBM's earnings by about $100 million before taxes, according to one analyst.

Accounting policy changes IBM has adopted since 1983 have enhanced its earnings by perhaps as much as $1.20 per share. They include switching to straight-line depreciation and raising the actuarially assumed rate of return on its $14.8 billion pension plan.

Jon Rotenstreich, vice president and treasurer, confirmed IBM executives are considering early implementation of FASB 87, but he could not say when that would happen. A company spokeswoman said officials will "re-examine its assumed rates of return" if they adopt the new standard.

Like early implementation of FASB 87, most accounting changes made by IBM have boosted earnings per share.

Thornton O'Glove, an analyst who follows IBM and the author of the Quality of Earnings Report, Englewood Cliffs, N.J., said he views IBM's ongoing accounting changes as a good thing, and generally positive for investors.

Citing an accounting equivalent of Gresham's Law, that bad money drives out good, he said liberal accounting principles drive out conservative accounting principles. The changes made at IBM not only bring it into line with its industrial peer group, but also add about $1.20 in earnings per share for 1985.

He believes the net result is that IBM's share price is 20 points higher than it would otherwise be. (IBM was at 149½ April 8.)

"Professors like to say that the efficient market adjusts stock prices for accounting policies, but that's a lot of hogwash," he said. He noted IBM's price-earnings multiple actually rose throughout the period when the more liberal accounting policies were adopted.

"Despite these changes, IBM is not out of line at all. You could not say that it was more liberal than its peers. These changes have just brought it into line with its competitors," said Mr. O'Glove.

Until 1983, IBM's conservative accounting policies spilled over to the reporting of its pension obligations. The company in 1983 adopted a two-stage interest assumption, using 7.5% for the first 10 years after adoption of the assumed rate, and 5.5% thereafter. These were raised to 8% and 6%, respectively, last year.

In 1983, IBM reported a fund contribution of $1.18 billion, including amortization. By 1985, the annual contribution had dropped to $868 million.

As a result, pension fund costs as a percentage of compensation at Big Blue dipped to 5% in 1985 from 9.7% in 1983. The contribution is expected to

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FASB 87 process called a charade

By Richard J. Gillespie

The lengthy process leading to the adoption of Financial Accounting Standards Board Statement 87, which placed pension liabilities on corporate balance sheets, was a charade, some members of the advisory task force on the standard charge.

They contend the FASB staff assigned to the project had decided on the standard about 10 years before it was adopted, and ignored opposition views along the way.

From the time the staff made up its mind on Statement 87, some task force members claim, the FASB staff engaged in a shrewd

ingly heated opposition from among the very task force members it had appointed earlier.

But Timothy S. Lucas, the project director for the FASB's Statement 87, denied the charges.

"None of the comments we got from task force members or other constituents were ignored. We appreciated everything we got," he said.

The task force, made up of experts and interested parties, made recommendations to the FASB and reviewed the proposals.

"The FASB ignored the advice of its own task force," said Bernard Sacks, a task force member and a certified public accountant with OAO Corp. in Greenbelt, Md.

"It just went ahead and didn't listen," he said.

"The staff does what it wants to do and I think the task force was just a charade. The staff runs its own show and it takes the input from the task force. If it agrees, then fine; if not, then too bad," he said.

Mr. Sacks also questioned the way the FASB staff categorized the written comments on preliminary proposals as pro or con.

"My own view is that the final version differed greatly from what we discussed, and that is not to say it is wrong," he said. He added he would have voted against FASB Statement 87 had he had the opportunity.

In interviews with 19 of the 28

Goldman seeds LBO fund with $25 million

By Marci Baker

NEW YORK — Goldman, Sachs & Co. is launching a $250 million leveraged buy-out fund in which it will invest $25 million of its own capital.

This marks the first time Goldman's own money will be used to finance acquisitions and one of the few instances in which it will provide any form of discretionary asset management to investors.

Wall Street

In another leveraged buy-out development, Forstmann Little & Co. early this month began marketing its third and most ambitious management buy-out partnership. The firm is seeking $1 billion from pension funds and other institutional investors and reportedly has received informal commitments for as much as half of that.

Pension executives at General Electric Co., Stamford, Conn.; Texas Instruments Inc., Dallas; and Minnesota Mining & Manufacturing Co., St. Paul, are among those looking at investing in the

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One New York City

ADRs

The *P&I Age* monthly indexes track the changes in the Standard & Poor's 500 stock index, the Russell 3000 stock index, the Ryan Index of fixed-income securities and the Shearson Lehman Government/Corporate bond index.

***P&I Age* March indexes**

	Latest mo.	Year to-date	Trailing 12 mos.
S&P 500	5.6	14.1	37.7
Russell 3000[1]	5.4	14.7	37.7
Ryan Index[2]	5.0	11.1	35.0
Shearson Lehman Gov't./Corp.[2]	3.5	8.5	28.9

Source: Rogers, Casey and Barksdale Inc.

[1]Frank Russell Co. [2]Fixed income.

SEC could weaken soft-dollar policies

By Joel Chernoff

WASHINGTON — The Securities and Exchange Commission next week may loosen the clamps on what research services money managers may purchase with soft dollars.

The interpretative release the commission will consider April 22 is looser than what SEC staffers previously said they wanted. It would allow the full use of such payments as long as the research aids the investment process. Such an interpretation eliminates a controversial test requiring the research product not be "commercially available."

The proposed interpretation also would cause managers to allocate costs between investment-related and administrative uses of such products, possibly creating bookkeeping complications.

If the SEC adopts the interpretation, it will have a limited direct effect on pension fund executives using soft dollars. They largely will face regulation by the Department of Labor, said Richard Wessel, associate director of the commission's division of market regulation.

Pension fund executives who hire outside money managers are not covered by the SEC interpretation because they do not exercise investment discretion, Mr. Wessel explained. Even if the fund runs money internally, he said the SEC rules are less likely to apply than the Employee Retirement Income Security Act.

The Labor Department will issue a release simultaneously with the SEC's effort, said Mort Klevan, deputy administrator of the Pension and Welfare Benefits Administration. "I don't think anybody who reads the Labor Department's requirements will be surprised," he said.

In recent months, department officials have emphasized that plan assets be used solely for the benefit of plan participants and beneficiaries, not for the gain of the plan sponsor.

For example, if a plan normally pays its master trustee fees from plan assets, soft dollars could be used instead. Where the fee is a legal obligation of the corporation, payment in soft dollars would be viewed as a prohibited transaction between the plan and a related party.

In addition, pension fund executives are expected to monitor their investment managers periodically to ensure they get best execution on trades and the amount of research bought with soft dollars is reasonable.

The SEC staff's recommendations relate to what qualifies as research under section 28(e) of the 1934 Securities Exchange Act. Under that rule, investment managers may direct trading to specific brokers, who then rebate a portion of the commissions in research services or products.

Thus, a manager might direct a portion of its brokerage business to a particular firm if it got, say, 50 cents in research services for each dollar in commissions paid. Pension fund executives, becoming wise to the use of directed commissions, increasingly have demanded a portion of the soft-dollar pie.

Part of the problem with the current interpretation of 28(e) is rapid technological advances in investment services have outdated earlier notions of what qualifies as research. For example, it is unclear whether computer hardware or computer time-sharing, which could be used for multiple purposes, is considered research by the SEC.

In addition, services such as quotation machines or certain periodicals are not considered research because they generally are available to the public.

The proposed interpretation would hew much closer to the law's original language, requiring research to be anything that "proves lawful" and provides appropriate assistance in the investment decisionmaking process. What's more, it would drop the "not commercially available" requirement.

While the details of the proposal were not available, industry experts favored the broad outlines of the revised interpretation.

"I think that's the way it should have been (all along)," said Robert Kittredge, general counsel for Loomis, Sayles & Co. Inc., Boston, and chairman of the Investment Counsel Association of America Inc., a New York-based industry group.

Keith J. Rudolf, partner and legal counsel for Stein, Roe & Farnham, Chicago, said, "I think it will clearly be an improvement."

Lee Pickard, partner in the Washington law firm of Pickard & Djinis and a former SEC official, said the new approach is "more realistic and it gives a better sense to the fiduciary to what he can or cannot do."

But the interpretation would substitute a new requirement that managers using the 28(e) exemption allocate the costs of

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12 Minnesota, PRIT advisers agree

Plans use incentive fees

By Chuck Paustian

Two large public retirement systems are placing 12 of their 18 existing equity investment managers, running a total of $1.15 billion in assets, on performance-based fees.

- Ten of the 11 active equity managers at the Minnesota State Board of Investment, St. Paul, will be on performance fees effective July 1, said Howard J. Bicker, executive director. The 10 invest a total of about $1 billion of the board's $8 billion in assets.
- Two of the seven active equity managers for the $1.2 billion Pension Reserve Investment Trust Fund, Boston, also will be under performance fees, said Daniel J. Kelly, director of program development for the fund. The two manage about $145 million.

The move by the two funds and others before them to performance fees might ease the way for corporate pension executives to establish similar arrangements with their funds' money managers.

Corporate pension funds are subject to the Employee Retirement Income Security Act, and must apply for an exemption from the Department of Labor before they can adopt performance-based fees.

The Labor Department, however, is expected to provide further guidance on the use of incentive fees by corporate plans later this year (*Pensions & Investment Age*, March 3).

Mr. Bicker said the Minnesota investment board, which oversees the investment of several pension plans for state and local public employees, decided to implement the fee arrangements so the performance risk was more equally dispersed.

"We think the risk of performance should be borne by both the manager and the plan sponsor. Right now it is borne only by the plan sponsor," he said.

Mr. Bicker would not disclose the names of the managers being placed on incentive fees.

Industry sources, however, said Alliance Capital Management Corp., IDS Advisory Group, Investment Advisors Inc. and Norwest Bank, all in Minneapolis; BMI Capital Corp., New York; Hellman, Jordan Management Co. Inc., Boston; and Waddell & Reed Asset Management Co., Kansas City, Mo., have agreed to the fees.

An official of Fred Alger Management Inc., New York, said the firm has had discussions with several clients regarding performance fees, but has not yet agreed to any of the arrangements.

Executives of Beutel Goodman Capital Management Ltd., Houston, and Forstmann-Leff Associates Inc., New York, would not comment. Executives at Lieber & Co., Harrison, N.Y. could not be reached for comment.

Mr. Bicker said the managers' fees will be determined by their performance relative to their normal portfolios.

A normal portfolio is a group of stocks the investment manager would select from when constructing a portfolio for the client. The normal portfolio serves as an investable alternative for a particular manager's style and allows the fund executive to determine the amount of value added by the manager.

"With performance-based fees, you have to have a bogey that is appropriate," said Mr. Bicker.

Under the terms of Minnesota's arrangement, a manager could receive a fee as high as 1% of assets managed if performance exceeded the normal portfolio by 1,000 basis points.

The manager would not receive any fee if he underperformed his normal portfolio by more than 600 basis points. The managers' investment objective is to outperform the normal portfolio by 200 basis points.

If the manager's performance equaled the investment objective, the manager would receive a base fee of 50 basis points.

(One hundred basis points equal one percentage point.)

Mr. Bicker said Minnesota's managers were generally receptive to performance fees, although a

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Corporations eye FASB 88

By Chuck Paustian

Corporate financial executives are showing increasing interest in a provision in the Financial Accounting Standards Board's Statement 88 allowing surplus pension assets to be recognized on the income statement without terminating the plan.

The statement, which permits the recognition of a portion of surplus assets after a like amount of the pension obligation has been satisfied through the purchase of annuities, eventually could lead to a decline in the number of plan terminations.

So far, Manufacturers Hanover Corp., New York, is the only corporation known to have used the provision.

Accountants and actuaries, however, said executives at many other companies may implement it in the near future.

What attracts them is the ability to boost earnings through the recognition of surplus pension assets without going through the rigors of terminating a defined benefit plan.

"You avoid all the governmental filings and everything else," said Robert B. Aglira, a principal of William M. Mercer-Meidinger Asset Planning Inc., Philadelphia.

Manufacturers Hanover, for example, purchased $125 million in annuities for its $550 million pension plan, according to Eugene M. McQuade, senior vice president and controller.

As a result, Manufacturers Hanover boosted its income (on its income statement) by $53 million for fiscal year 1985, ended Dec. 31 (*Pensions & Investment Age*, March 17).

But other companies aren't rushing to follow Manufacturers Hanover's lead. "Perhaps the biggest reason that companies might hesitate is (the purchase of annuities) represents a reinvestment of assets," Mr. Aglira said.

The corporate executives may be waiting for higher interest rates, which would result in lower purchase costs.

Annuities are "just another place for the plan to put the assets," said Rowland M. Davis, a principal of Towers, Perrin, Forster & Crosby, Chicago. "It's an investment decision," he said.

Mr. Davis also said the purchase of annuities may reduce some of the volatility in a company's pension expense.

In addition, a company first must recalculate its pension figures to determine the amount of surplus assets available. Before a company can implement Statement 88, it first must implement FASB statement 87, which

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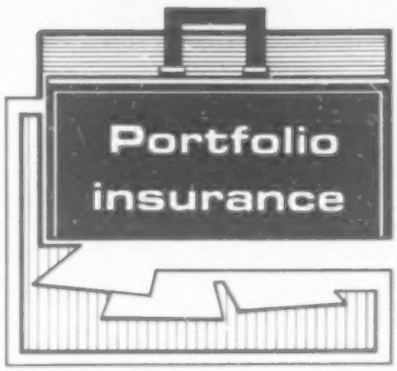
Dynamic hedging grows despite debate

By Trudy Ring



The amount of pension assets protected by dynamic hedging, also called portfolio insurance, has increased more than 40 times during the past two years — to at least $8.5 billion — but the product remains controversial.

The strategy involves the sale of stock index futures or fixed-income futures against a portfolio in reaction to a drop in financial markets, and sometimes buying them in reaction to rising markets. For most clients of Leland O'Brien Rubinstein Associates Inc., the leading dynamic hedging manager, futures would be sold when the value of the protected portfolio dropped 3%, said Hayne Leland, managing director of LOR. If the drop were temporary and the portfolio's value started moving up again, the futures would be bought back after a 3% move upward, he said.

Some clients do have different buy-sell timing criteria, and the criteria may be adjusted according to how fully invested the protected portfolios are, he said.

The program is designed to guarantee investors a minimum rate of return while allowing the capture of upside gains, less the cost of the protection.

It is not an insurance policy, but has come to be called portfolio insurance because of the assurance of a minimum return.

Generally, the manager implementing the dynamic hedging strategy will handle only the futures sales or purchases, without interfering with a pension fund's other managers.

The strategy has attracted many large corporate pension plan sponsors, such as Manville Corp. and Gates Corp., both of Denver, and Trans World Airlines Inc. and J.P. Stevens & Co., both of New York. Some public pension funds, such as that of the Southern California Rapid Transit District, Los Angeles, and at least one church fund — the New York-based Episcopal Church Pension Fund — also have adopted the strategy.

Executives of many other retirement funds are taking a look at it. "I think there may be some possibilities there," said Nathaniel Duffield, chairman of the profit-sharing committee at Halliburton Co., Duncan, Okla.

John Steinbach, assistant treasurer and investment manager at K mart Corp., Troy, Mich., said he would like to get his board's approval to put a dynamic hedging program in place during the current market cycle, if it lasts another couple of years, or else during the next bull market cycle.

"I think any locking in of profits for a pension fund is very prudent in this type of market," he said, adding K mart has used other means to lock up gains.

But enthusiasm for the product is not universal. Some pension executives have considered it and rejected it.

"We have not felt, as of now, that it's appropriate," said Howard Carlson, pension fund manager at Commonwealth Edison Co., Chicago. He said he finds it hard to believe the strategy will work the way it's supposed to.

Edward T. Tokar Jr., vice president-investments at Allied-Signal Inc., Morris Township, N.J., said he's always a bit skeptical of the latest hot investment — once, it was oil and gas; another time, small growth

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Benefit losses told

Effect of plan terminations studied

By Joel Chernoff
and Chuck Paustian

WASHINGTON — Plan participants suffer benefit losses when their terminated defined benefit plan is replaced with a defined contribution plan or is not replaced, but not when it is replaced with a defined benefit plan, preliminary findings of a study show.

Meanwhile, two companies, NL Industries Inc., New York, and Baker International Corp., Orange, Calif., announced their intention to terminate defined benefit plans and recapture a total of $220 million.

NL Industries will replace its terminated plan with another defined benefit plan, while Baker International intends to replace its plan with a defined contribution plan.

The Labor Department-funded study, which is expected to be completed by the April 15 meeting of a special task force on terminations of overfunded plans, is being performed by Hay/Huggins Co. Inc., Philadelphia.

The task force either will make recommendations or present a range of options to its parent body, the ERISA Advisory Council, a group of private-sector experts who advise the secretary of labor on benefit issues.

The council has postponed its meeting to vote on the task force's recommendations to May 14 and 15 (from April 30) to study the task force's advice.

T. Timothy Ryan Jr., the task force's chairman and a member of the advisory council, said the task force is considering maintaining the status quo, eliminating or changing the Reagan administration's May 1984 guidelines on asset reversions or permitting employers to retrieve surplus assets without terminating their plans.

One source said the task force is exploring requiring an employer that wants to withdraw excess assets without terminating to leave a cushion of 10% exceeding the level of accrued benefits, in addition to existing requirements of vesting all benefits and purchasing annuities for those benefits.

The preliminary findings of the Hay/Huggins study also show spinoff/terminations involve no benefit losses because participants automatically receive credit for past service.

In a spinoff/termination, a plan

T. Timothy Ryan Jr.

is divided into two, one for active employees and one for retired employees. Once annuities have been bought for the accrued benefits of active employees, the surplus assets are shuttled into the plan for retirees, which is then terminated, allowing the employer to recap[illegible] the excess.

Similarly, when the employer terminates the entire overfunded plan and replaces it with a similar plan, participants do not lose benefits in "the vast majority" of cases, Mr. Ryan said, because most successor plans provide past service benefits.

When no successor plan is provided, however, participants do suffer "substantial benefit losses," he said. Most of these cases involved business closings.

Where the original defined

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Cash positions stable through first quarter

By Chuck Paustian

The cash positions of active equity managers were virtually unchanged during the first quarter of 1986.

The percentage of cash held by active equity managers in their portfolios dropped during the first quarter of 1986, but most of that decrease was attributable to the current bull market.

According to INDATA, an investment analysis service of Gordon, Haskett & Co., Southport, Conn., institutional equity portfolios finished the quarter with 6% cash, compared with 6.9% cash at the end of 1985. For the first quarter of 1985, equity portfolios finished with 6.3% in cash.

During the first quarter, the equity market, as measured by the Standard & Poor's 500 stock index, was up 14.1%.

"If you adjust for market values, it appears managers raised cash in 1985, and they have held steady in 1986 so far," said William T. Kennedy, partner in the Atlanta office of INDATA.

The INDATA statistics are based on a universe of 1,189 equity managers.

The cash reserves of managers tracked by *Pensions & Investment Age*, ranged from less than 5% (at Alliance Capital Management Corp., New York) to 25% (at First Chicago Investment Advisors, Chicago).

Managers interviewed apparently are cautious about the market; they said their cash reserves, as a percentage of the portfolio's assets, generally were at the same levels March 31 that they had been for the past several months.

Those reporting slightly lower cash figures attributed most of the decline to the equity market, while those with slightly higher cash reserves said the increase resulted from the inability to find properly valued stocks.

Jon Fossel, senior vice president of Alliance Capital, said the firm's cash position of a little less than 5% is about where it has been for "quite a while." At the end of the year, Alliance reported cash reserves at 5%.

"The only reason it would be less than 5% is because the value of stocks went up," he said.

"Our view is that the stock market in general is now fairly valued, not overvalued, relative to the

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Public funds move most money

By Trudy Ring

Large public pension funds were the major movers of money to new investment managers in the first quarter, reports in *Pensions & Investment Age* show.

Batterymarch Financial Management, Boston, and Citicorp Investment Management, New York, each received $500 million to manage from the $34 billion California Public Employees' Retirement System. These accounts, for equity management, made Batterymarch and Citicorp the hottest managers of the quarter in terms of assets gained from new clients.

The hottest — and coldest — managers were identified through reports published in *P&I Age*. Managers may have gained or lost other accounts that were not reported.

and Citicorp, they also hired Rosenberg Capital Management, San Francisco, as an equity manager. The amount to be allocated to Rosenberg was being negotiated.

Batterymarch is a contrarian manager, investing in stocks that are out of favor, while Citicorp and Rosenberg emphasize growth. The assets allocated to these firms had been run in-house.

Another California public fund, the $16 billion State Teachers' Retirement System, had major moves reported in the first quarter. It hired five managers to invest $100 million each in growth stocks of medium-capitalization companies.

The five are Denver Investment Advisors, Denver; Equitable Investment Management Corp., New York; Pilgrim, Baxter, Hoyt & Greig Capital Calif.; and Wright Investors' Service, Bridgeport, Conn. The teachers' system funded them from cash flow.

Wright had one other new account reported during the quarter — a $12.5 million equity account for the $300 million Bush Foundation, St. Paul, Minn.

Rounding out the top gainers were Wells Fargo Investment Advisors, San Francisco; Prudential Asset Management Co. Inc., Newark, N.J.; and Wilmington Trust Co., Wilmington, Del.

Wells Fargo had $200 million from four accounts, the largest being a $110 million bond index fund for the $1.3 billion Rockefeller Foundation, New York. Oppenheimer Capital Corp., New York, previously managed the money.

Also during the first quarter, it was reported the California billion, making the firm manager of a total of $4.5 billion for the system. The teachers' fund reported it had made that shift during the fourth quarter of 1985, so it was not counted in the first-quarter totals.

Prudential Asset Management's $121 million in new assets reportedly came from three clients. The biggest account was a $60 million guaranteed fixed-income portfolio for the $190 million Chemical New York Corp. profit-sharing plan. Most of the money came from the refunding of contracts with another carrier, whose name was not released.

Wilmington Trust won a $115 million fixed-income account for Kaiser Aluminum & Chemical Corp., Oakland, Calif. The $470 million Kaiser fund shifted to completely

Most new accounts*
1st quarter 1986

Firm	New accounts
Bankers Trust Co.	9
Neuberger & Berman	5
Dreman & Embry Inc.	4
The Boston Co.	4
Investment Advisers Inc.	4
Palmer Organization	4
Wells Fargo Invest. Advisors	4

* As reported in *Pensions & Investment Age*

Most new assets*
1st quarter 1986

Firm	($ mil.)
Batterymarch Financial Mgmt.	$500
Citicorp Investment Mgmt.	500
Wells Fargo Invest. Advisors	200
Prudential Asset Mgmt. Co.	121
Wilmington Trust Co.	115
Wright Investors' Service	113
Denver Investment Advisors	100
Equitable Investment Mgmt.	100
Pilgrim, Baxter, Hoyt & Greig	100
Provident Investment Counsel	100

Cash Management

Pepsi uncaps Euromarket

Several follow lead in commercial paper

By Richard J. Gillespie

Eastman Kodak Co., IBM Credit Corp., General Electric Co. and Upjohn Co. are following a lead taken by PepsiCo Inc. in issuing Eurocommercial paper.

PepsiCo recently set up a commercial paper operation on the Eurodollar market in which it offers to buy back any excess paper from its dealers to prevent them from creating a secondary market.

Furthermore, rather than issuing paper in a series of preset maturities, PepsiCo bids on an investor's needs, offering maturities from seven to 183 days, according to Peter Houchin, vice president with PepsiCo, Purchase, N.Y.

With the technique, PepsiCo essentially has managed to crack the market that had proved troublesome to earlier issuers. By early April, it had outstandings (the amount of an issue outstanding) of $225 million, and the paper was priced more aggressively than anything else on the market except for Canadian Export Corp., a supranational agency.

The technique is being widely copied by other U.S. issuers, most notably IBM Credit Corp., which already has begun posting rates.

"I think we started a trend," said Mr. Houchin. "The interesting thing to us is that we see some other programs coming to the market now, such as IBM Credit Corp., which are modeled after ours, and we are kind of excited about that."

U.S. corporations only recently began selling commercial paper directly onto the Eurodollar market, and some of the early entrants were surprised to find it could backfire, according to Mr. Houchin.

Because of conditions peculiar to the market, issuers sometimes found underwriters who had bid aggressively for the business later dumped the paper onto the secondary market, sometimes taking a loss and often interfering with the company's ability to issue on the primary market at favorable rates.

As a result, some major U.S. issuers — including most of those listed above — had eschewed the market.

"My feeling is that many of them felt why bother with Europe. Most of them had snubbed the market and said it is not there and evidently they now feel that they were wrong," said Mr. Houchin.

But while most corporations using PepsiCo's innovation now intend to list their paper on the Eurodollar market specifically to take advantage of the lower rates available, PepsiCo had another reason for the move, he said.

Not only is it developing its non-U.S. investor base, but by doing so, it hopes to guard against the possibility of saturating the U.S. domestic market.

As an added benefit, PepsiCo found it has garnered a lower borrowing cost through its Eurocommercial paper program.

On a typical day this month in Europe, PepsiCo was issuing paper seven basis points below what it was in the U.S. domestic market on an all-in basis (which included the dealer spread).

In Rochester, N.Y., Eastman Kodak spokesman Henry Kaska said the company was registering to issue directly onto the London Eurocommercial paper market.

But unlike PepsiCo, which generally intends to use its Eurocommercial paper facility as a supplement to its domestic operation, Eastman Kodak sees its program as an "either/or sort of thing," said Mr. Kaska.

"We view this program as an alternative to the U.S. commercial paper market and funds from the program will be used for regular working capital requirements."

Eastman Kodak, which first entered the U.S.

Continued on page 20

Payden & Rygel index of short maturity assets*
(for year ended Dec. 31)

	December 1985	Quarter ended 12/31/85	Year 1985	12 months ended 12/31/85	Yield level monthly change*
	Unannualized total returns				
90-day					
U.S. Treasury bill	0.6551	1.8910	8.3071	8.3071	−11
Domestic CD	0.8981	2.0447	8.6089	8.6089	−13
Euro $ CD	0.7132	2.0712	8.7843	8.7843	−17
180-day					
U.S. Treasury bill	0.7361	1.9397	9.0851	9.0851	−18
Domestic CD	0.7260	2.0989	8.9470	8.9470	−16
Euro $ CD	0.7416	2.1525	9.2327	9.2327	−17
1-year					
U.S. Treasury note	0.9841	2.3533	10.3671	10.3671	−25
2-year					
U.S. Treasury note	0.5562	3.8000	13.3730	13.6730	−48

*Figures are unannualized total returns. Year-to-date and 12-month figures linked monthly. 90- and 180-day Treasury bill yield level changes on discount basis.
*Basis points.

Source: Payden & Rygel, Los Angeles

Because of a discrepancy between the publishing schedules of *Pensions & Investment Age* and Payden & Rygel, the year-end index results, shown here, were not printed in January. Managers should note, however, the matrix assumes there were no cash flow constraints imposed.

Companies review lockboxes in effort to lower expenses

By Chuck Paustian

Several companies are hoping to save hundreds of thousands of dollars annually through the consolidation of their lockbox operations.

A number of factors have contributed to the need for consolidation. Reorganization of corporate structures and spiraling banking costs have forced companies to look for ways to reduce overall expenses; lower interest rates have decreased the value of a single day's cash inflow, reducing the need to accelerate collections in order to maximize their investment potential; and the Federal Reserve Bank's High Dollar Group Sort program has accelerated the check-clearing process.

Among the companies recently completing studies of their lockbox operations are Marathon Oil Co., Findlay, Ohio, and Diamond Shamrock Corp., Dallas.

Combustion Engineering Inc., Stamford, Conn., already completed its consolidation efforts and reports saving about $300,000 to $500,000 annually.

"One of the main reasons companies are (consolidating) is simply because they want to lower expenses," said Shirley J. Gilmer, a vice president of RepublicBank Dallas.

Also, the decline in interest rates has reduced the need to accelerate the collection process as the potential return on investment has been lowered.

"One of the points of cash management is the time value of money and if the value of money is lower, you don't have to optimize it as much," said Ms. Gilmer.

"When you have something like what our present situation is . . . it's time to look at what your benefit is and what your cost is," said Chet L. Andrews, vice president at VALUTECH, a cash management service provider, Santa Ana, Calif.

"From an economic standpoint, the two key components that go into your equation (the cost of lockboxing vs. the benefits gained) have changed dramatically," said Cathy L. Rollins, a principal of Treasury Strategies Inc., Chicago.

Although corporations routinely review their lockbox operations every two to three years, the higher bank costs and lower benefits create the need to re-evaluate the lockbox system.

"That equation is no longer good because interest rates have changed so much," said Ms. Rollins.

Besides the economic reasons for consolidating a lockbox system, the Federal Reserve Bank's program and its improved technology also give cause for reviewing a company's operations.

Under the program, banks presented with more than $10 million from outside their district will receive a second presentation of items drawn on that bank from the Federal Reserve.

"The Fed did that with the idea they wanted to speed up the check-clearing process," said Larry Marks, president of Phoenix-Hecht, a cash management consulting firm in Northfield, Ill.

Roger L. Hawley, manager-domestic funds department at Marathon Oil, said all of these factors came into play when conducting a review of the company's lockbox network.

"We were aware that a lot of things have changed since we did our last study in 1982," said Mr. Hawley.

Marathon, with $10 billion in revenue during 1985, collects

Continued on page 20

Cash notes

Monitoring starts

NEW YORK — March 27 came and went and the world didn't end.

That was the date the Federal Reserve began ex-post monitoring bank intraday overdrafts on FedWire and the Clearing House Interbank Payment System.

That things went smoothly came as no surprise. The assistant director of Federal Reserve Bank operations, Elliott McIntee, had predicted as much.

"At this point we have had no earthshaking things happen," said Susan Clark Shellington, assistant director of treasury services at Bell Atlantic Corp., Philadelphia, and chairman of the National Corporate Cash Management Association's Federal Reserve Liaison Committee.

According to Ms. Shellington, the NCCMA has scheduled a May 1 meeting with the Federal Reserve to go over the data for the program's first month.

According to a spokesman for the Federal Reserve Bank of New York, not only did the exercise go smoothly the first day, but indications were that institutions stayed within the voluntary caps.

It was more or less a typical day on FedWire, he said, with 89,500 transactions totaling about $370 billion.

On the CHIPS network, things also went smoothly although volumes were a little higher than usual at about $600 billion.

It was one of CHIPS' biggest days ever, according to John Lee, executive director, partly because it was at the end of the month and end of the quarter.

CHIPS operates on a computer system that monitors intraday overdraft positions as it goes along, he said. Caps are set on a daily basis and payments that

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Leasing

An update on corporate leasing: a review of '85 and a look to '86

Deals still brewing despite tax threat

By Marci Baker

The threat of tax reform may be keeping some corporations and investors out of the leasing market, but for others it's business as usual.

Leasing industry participants note several major leasing transactions are in the works or on the drawing boards. They include:

- A roughly $50 million leveraged lease financing of two new Boeing planes for AirCal Inc., Los Angeles. The deal, just completed, was privately placed with two investors through Paine-Webber Inc., New York.
- The sale-leaseback of the state-of-the-art auto facility being built by Mazda Motor Corp., Flat Rock, Mich. The leveraged lease transaction reportedly totals $500 million. Co-agents are Goldman, Sachs & Co. and Sumitomo Bank of Japan. Officials of Mazda and Goldman declined to comment on the deal.
- A possible aircraft leasing transaction by Federal Express Co., Memphis, Tenn. The company expects to accept delivery of three new DC-10 freighters from McDonnell Douglas Corp., St. Louis, within six months. Although no decision has been made on the financing of the aircraft, a Federal Express official said the company is looking into a leasing transaction as well as direct purchase.
- The sale-leaseback, through Paine-Webber, of as much as one-half of El Paso Electric Co.'s $1.5 billion interest in Unit 2 of the Palo Verde nuclear power project near Phoenix, Ariz. El Paso Electric, El Paso, Texas, is following the lead of Public Service Co. of New Mexico, Albuquerque, which sold part of its interest in the project for $325 million late last year.
- The sale-leaseback of Public Service of New Mexico's remaining interests in Palo Verde. The utility is working with Kidder, Peabody & Co. and Goldman, Sachs on the nearly $600 million transactions.
- A quasi-asset-backed financing through the private markets involving farm equipment leases by Deutz-Allis Credit Corp., West Allis, Wis. The deal could total as much as $100 million and is being placed through First Boston Corp.

Most leasing transactions continue to rely on the sale of tax benefits to investors and are being structured under the assumption that they will be grandfathered under any new tax law Congress may pass.

"The market isn't grinding to a halt just because there's a tax bill out there," said Daniel Lief, vice president at Goldman, Sachs.

"People believe Congress will be reasonable as they have been historically and establish effective dates for tax changes that won't affect already completed transactions."

Also, structuring tax-sensitive deals under the cloud of tax reform is not new to lessors and lessees; Congress has been threatening repeal of the investment tax credit and other reform measures for several years now.

"Tax ramifications have become generic to the leasing business," said Robert Starnes, corporate manager-financial services at Public Service of New Mexico. It's routine to include provisions to adjust the terms of the deal in the event of tax law changes, he said.

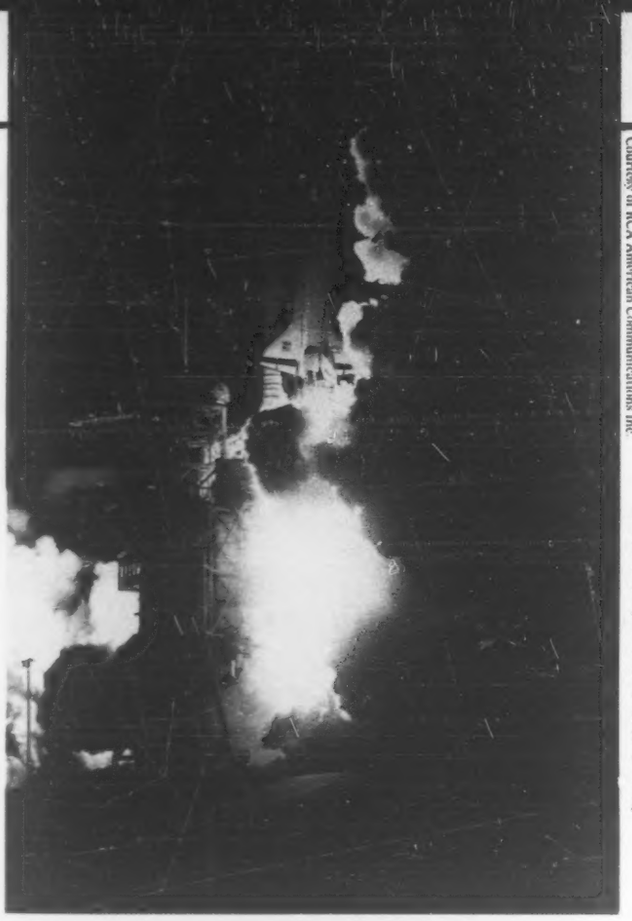
That's the case in Public Service of New Mexico's sale-leaseback activities and likely will be so for El Paso Electric as well.

El Paso Electric wants to do a sale-leaseback for part of its 15.8% interest in Unit 2 of Palo Verde, which for tax purposes is scheduled to go into operation this month. The debt portion of the $500 million to $700 million transaction, which may also involve El Paso's interest in the nuclear project's common and switchyard facilities, is expected to be raised through the public markets.

The deal will have to close by midsummer or the utility will lose the ability to pass on tax benefits to investors in the deal, said William Royer, treasurer.

Mr. Royer couldn't comment on the

Continued on page 34



Courtesy of RCA American Communications Inc.

The space shuttle Atlantis, lifting off in November, ferried RCA Corp.'s leased Satcom K2 into orbit. RCA's $314 million sale-leaseback of the satellite was one of last year's 10 largest lease financings.

Sale-leaseback role seen in utilities' debt refunding

By Marci Baker

Some utilities will refund existing high-coupon debt at par during 1986, analysts and investment bankers say.

Analysts estimate as much as $10 billion in high-coupon debt could be refunded by utilities this year if interest rates remain constant or decline.

At least some utilities are expected to substantially cut their interest costs by taking advantage of loopholes in their old bond covenants and forcing investors to turn in those premium bonds at par rather than at general redemption prices. And sale-leasebacks could be the mechanism for calling the bonds.

The spotlight has centered lately on special par call provisions relating to utilities' maintenance and replacement funds, which ensure a utility has enough reserves set aside to maintain operating plants.

But special "released property" provisions, frequently part of the terms of utility bond issues, may invite par calls of premium bonds as well, said Daniel Scotto, a utility analyst at L.F. Rothschild, Unterberg, Towbin, New York.

These provisions either require or give utilities the option to redeem high-coupon bonds at par with proceeds from property released from mortgages as a result of sale-leasebacks or other forms of asset sales.

More than 90 of 115 utilities carrying premium bonds on their books have issues with released property provisions allowing par calls, according to an 800-page electric utility bond redemption survey put together by Mr. Scotto. Generally those provisions leave the decision on par calls of premium bonds up to the utility, with mandatory par calls coming into play under specific circumstances such as a sale of assets to government entities.

The refunding risks tied to released property provisions from property sales haven't received much attention because the transactions are difficult to track and less visible.

"Utilities are constantly selling property, but the transactions are frequently small in size," making information difficult to obtain, Mr. Scotto said. "There hasn't been a major asset sale done to bring attention to the released property issue yet."

But that could change with the recent surge in large sale-leasebacks of utility power plants. In recent months, Tucson Electric Power Co., Tucson, Ariz.; Basin Electric Power Cooperative, Bismarck, N.D.;

Continued on page 34

Top 10 lease transactions of '85 total $4.1 billion

By Barry B. Burr

The 10 largest lease deals of 1985 accounted for almost a third of the $12.3 billion in privately placed equipment or plant leases arranged during the year.

The 10 largest deals totaled nearly $4.1 billion, according to IDD Information Services Inc., New York. That amount signals the leasing transactions' significance as a corporate finance tool, often individually rivaling in size many of the largest single debt and equity offerings in 1985.

Most of the biggest leases were by electric utilities and were initiated to transfer millions of dollars of underutilized tax benefits. Because of low earnings, the utilities, like many other lessees, couldn't take full advantage of the investment tax credit and accelerated depreciation benefits of owning. So they sold their interest in particular plants to companies that could, thereby lowering the cost of capital.

But tax change proposals in Congress are putting the tax-driven deals in jeopardy. Congress is likely to end the investment tax credit, which usually amounts to an immediate government subsidy of 10% of the cost of the equipment or plant through a tax credit.

A few of last year's biggest deals, however, were sale-leasebacks done mainly to enable the companies to record huge gains by selling assets worth more than the value reflected on the balance sheet.

The benefits of leasing are huge, both for lessees and lessors. Lessors gain tax benefits and pass part of them on to lessees in the form of lower financing costs.

General Electric Credit Corp., Stamford, Conn., a unit of General Electric Co., Fairfield, Conn., received an immediate $35 million in after-tax benefits for 1985 from its purchase of a cogeneration electric- and steam-producing plant from Cogen Lyondell Inc., Houston, a unit of PSE Inc., a Houston-based firm specializing in building cogenerating plants.

James H. Ozanne, GECC senior vice president, confirmed the $35 million first-year benefits, which amount to nearly half the $80 million GECC put up in equity to finance its purchase of the cogeneration plant, fueled by natural gas. The other $142 million was financed in debt from a group of banks.

By investing in the plant, GECC received for 1985 $18 million for taking an 8% investment tax credit on the $232 million plant and another roughly $17 million in an accelerated 15% depreciation.

PSE saved about two percentage points in its implicit interest cost by having its unit lease instead of borrowing to own, estimates Charles O. Svenson, senior vice president, Donaldson Lufkin Jenrette Securities Corp., New York, PSE's agent which arranged the lease financing.

Among the biggest deals of 1985 were the Springerville coal plant, Tucson Electric Power Co., Tucson, Ariz., agreed to sell for $850 million to $900 million and lease it back and the Spacenet 3 satellite transponder, GTE Corp., Stamford, Conn., agreed to sell for $248.4 million and lease it back.

The Springerville plant, whose lease arrangement is subject to state regulatory approval, isn't expected to begin operations until 1989. The GTE satellite was lost when an unmanned Ariane rocket carrying it into orbit malfunctioned and was destroyed shortly after launch in Kourou, French Guiana.

"A lessee can lease about anything" nowadays, said Buell T. Adams, treasurer, CBI Industries Inc., Oak Brook, Ill.

At the close of last year, a CBI unit, Liquid Carbonic Corp., sold an air separation plant expected to be completed in November in LaPorte, Ind., for $18 million to

Continued on page 35

Tax sensitivity avoided

Operating-lease, service-oriented programs selected

By Marci Baker

Leasing companies are intensifying efforts to move into less tax-sensitive markets to protect their businesses against potential changes in the tax laws.

Increasingly, lessors have been turning to the operating lease business or service-oriented vendor programs, which rely less on investment tax credits or accelerated depreciation and more on remarketing prowess and service-oriented relationships to achieve full returns on their investments.

They also are scouting out new markets where leasing activities hold out the potential for high yields without tax benefits.

In operating leasing, the investment return is more dependent upon the residual value of the equipment at the end of the lease than upon tax advantages arising from the lease. Operating leases generally are shorter than tax-advantaged ones, and are riskier because of the uncertainty about the future value of the equipment.

Although lessors continue to participate in such traditional, tax-oriented transactions as leveraged leases, those transactions are making up increasingly smaller portions of portfolios.

In 1985, tax-sensitive transactions made up slightly less than 50% of the transportation and industrial financing division's leasing activities at General Electric Credit Corp., Stamford, Conn. About 15% of its business in the first quarter of 1986 has been tax-sensitive, said James Ozanne, senior vice president and general manager of the transportation and industrial financing division at GECC.

The division focuses on large-scale equipment leasing, including aircraft, power generation stations and rail cars.

Likewise, John Hancock Leasing Corp., Boston, has flip-flopped its leasing portfolio since 1983, with tax-oriented leasing rep
senting between 10% and 1
down from as much as 90%
1983.

Equitable Life Leasing Co
New York, wants 50% of its le
ing volume to represent less t
oriented operating leases. T
activity was running at 42% of
lessor's sales in the first quarte
this year, up from only 8%
1983.

"We've been moving away fr
tax-oriented products since 19
said Daniel Hale, senior vice p
ident in charge of commercial
nancing at GECC. "Tax unc
tainty in the leasing business
existed every year since then. L
sors that want to remain comp
tive have been modifying (th
businesses) to focus more on
tax-sensitive kinds of products
a couple of years now."

GECC's commercial gro
focuses on middle-market leas
of such equipment as comput
and other high-technology equ
ment and trucks and trailers.
key area is vendor programs.

Whereas in traditional leasin
lessor such as GECC is largel
passive source of financing,
vendor programs the lessor
more active relationships w
both manufacturer and lessee.

GECC, for example, may l
equipment leased to customers
manufacturers and receive
rental payments on the short-t
leases. But in addition, it a
value to its investment by work
with manufacturers in their sa
training or equipment remark
ing, said Mr. Hale.

GECC has been building t
relationship-oriented business
part through acquisition. L
year, it purchased Decimus Co
which services and remark
computer and other high-techn
ogy equipment. The previous y
the company acquired Kerr Le
ing & Fleet Services Co. in effo
to expand its truck and hea
equipment leasing business.

GECC's transportation a
industrial financing group, me
while, has been moving m
heavily into the operating as
business. In line with that,
company is acquiring for $4
million the rail cars and as
ciated operating leases of No
American Car Corp., Chicago.

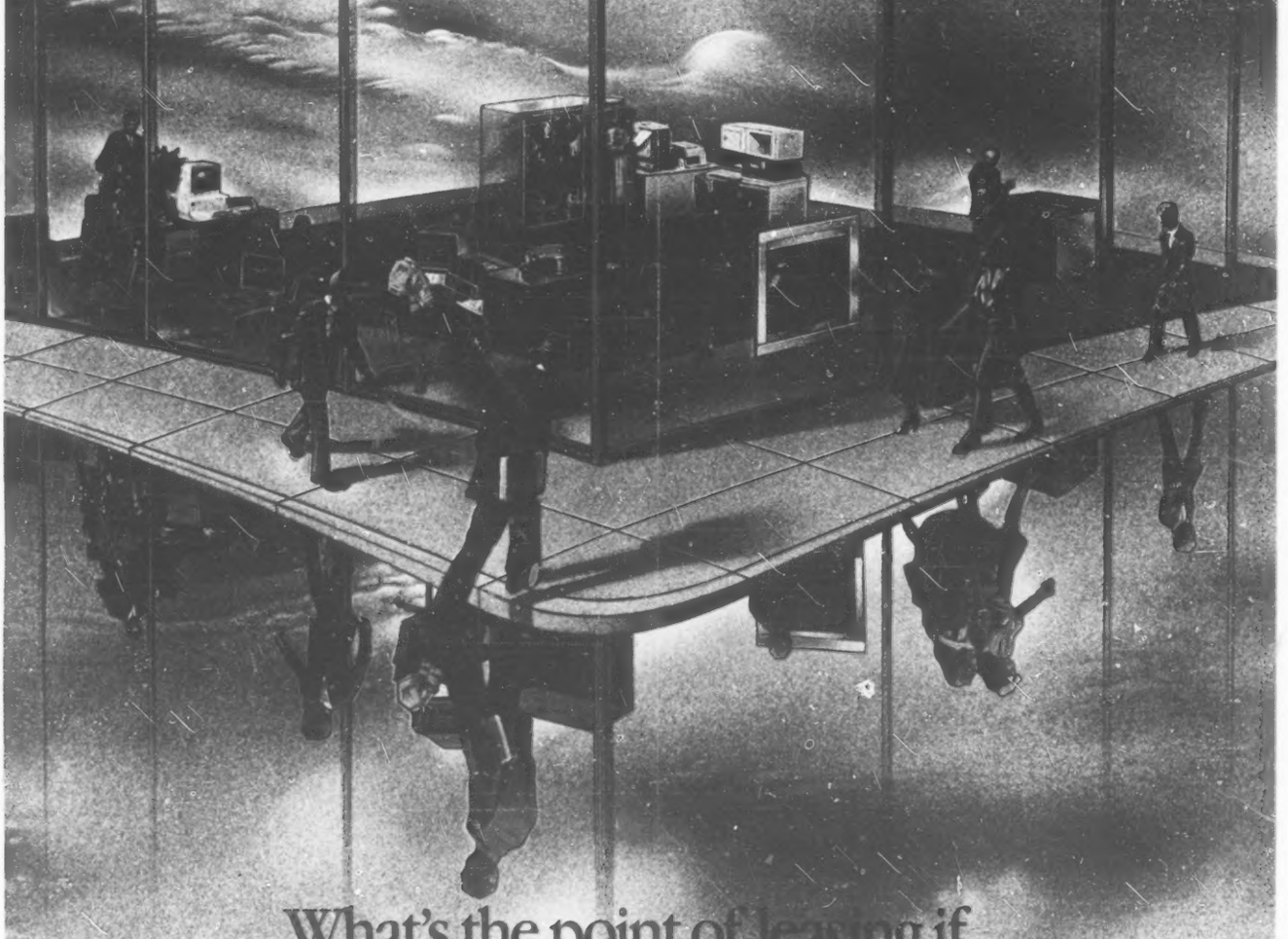
Moreover, the unit has be
shifting its emphasis on big-tic
financing activities from being
lessor, or equity participant,
leveraged lease-related deals
participating as an investor in
debt portion of transaction.
example, in the marine transp
arena, GECC last year redirec
its mix of new financing busin
from 80% in leasing to 75%
asset-based lending.

"We're still going after every
of traditional leasing business
can," said Mr. Ozanne. "But w
also preparing ourselves for
reform."

The operating lease business
pears to be generating the m
interest among lessors. T
shorter-term leasing transacti
have had their greatest appli
tion in high technology, wh
users are reluctant to buy equ
ment because new developme
quickly make older produ
obsolete.

The operating lease format a
can be used to finance the acqu
tion of major industrial equ
ment such as rail cars or aircraf

In these shorter-term leas
transactions, anywhere from 2
to 80% of the lessor's investmen
wrapped up in the residual va
of the equipment, whereas less
get back closer to all of the cos
equipment through rental p



What's the point of leasing if it mirrors the pitfalls of purchasing?

Here's the dilemma: Leasing is supposed to help you remain competitive by putting state-of-the-art equipment in your hands. And taking it off your hands as it becomes obsolete.

Yet, technology is moving so fast these days that you're likely to wind up with outdated equipment in the middle of a lease. In effect, you're apt to get stuck with (and stuck paying for) unproductive assets just as though you were purchasing them.

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Sale-leaseback . . .

Continued from page 31

Public Service of New Mexico, Albuquerque; and Montana Power Co., Butte, have sold new power generating stations to investors, who are leasing them back.

El Paso Electric Co., El Paso, Texas, is working on a sale-leaseback deal involving some of its interest in the Palo Verde nuclear power project near Phoenix.

Investment bankers say other utilities are eyeing the advantages of sale-leasebacks in an environment of overcapacity, increased competition and rate-sensitive public service commissions.

The deals enable utilities to avoid huge rate increases to consumers and reduce revenue requirements in the early years of a new plant's operation. In addition, sale-leasebacks put cash on the balance sheet and lower the cost of senior debt.

The opportunity for par calls on debt through released property provisions could make a sale-leaseback even more attractive.

"Historically, sale-leasebacks have been done largely to refund high-coupon debt," said Bruce Walenczyk, vice president at Kidder, Peabody & Co., New York. "I think in most transactions, the covenants on existing debt provide for call provisions at a premium."

Mr. Scotto indicated those provisions associated with the high-coupon debt of El Paso Electric would appear to make the utility eligible for released property redemption. William Royer, El Paso's treasurer, said the utility hasn't determined whether proceeds from the sale-leaseback will be used to redeem existing bonds or for other corporate purposes.

El Paso Electric, like others, likely would weigh its options carefully, because par calls typically invite investors' wrath.

If investor relations is one problem utilities would face in invoking released property provisions, another is determining whether they are even eligible for refunding debt at par with sale-leaseback proceeds. In most cases, the wording is hazy and would require a legal judgment on whether the utility qualifies.

For example, El Paso's released property provisions states proceeds from the "sale, taking or release of substantially all of the bondable property can be used to call bonds at par at anytime," according to the Rothschild report.

"'Substantially all of the property' — I'm not sure I know what that means," Mr. Royer said.

Some observers think public utility commissions — reluctant to approve electric rates increases — could pressure utilities to invoke released property provisions if a sale-leaseback appears to make them eligible for par redemption of high-coupon debt.

"I don't think there are many instances where the provisions would apply," said one banker. "But for those instances where they would, the rate boards would encourage utilities to do (a par call). The question is whether utilities could avoid doing the transaction." ■

Operating . . .

Continued from page 32

competition in what has become a very crowded market.

"Some of the new players that have come into the market in the last few years won't want to stick around," said GECC's Mr. Hale.

Many financing arms of industrial companies have been established predominantly as a means of sheltering income. Without the investment tax credit and other tax benefits, these operations will have little incentive to continue in the leasing business, lessors said.

The merger and acquisition wave may help fuel a shakeout as well.

The leveraged buy-out of Beatrice Cos., Chicago, for example, has effectively put its leasing subsidiary, Beatrice Financial Services, out of business. An official there said the subsidiary is not making any new leasing deals. The firm had been an investor in such leveraged lease transactions as the Basin Electric Power Corp.'s sale-leaseback of its Antelope Valley power station.

Instead, Beatrice officials will be focusing on paring the $6 billion to $7 billion of debt it has raised to finance the buy-out and on restructuring the company through asset sales. The restructuring potentially could include the sale of the financial services arm. ■

Goldman, PaineWebber top list

NEW YORK — Goldman, Sachs & Co. and PaineWebber Inc. together handled more than 40% of the $12.5 billion in privately placed equipment or plant leases done last year.

According to IDD Information Services Inc., New York, the two managers led the others in leasing placements by a wide margin.

As the accompanying chart shows, Goldman, Sachs ranked first, followed closely by PaineWebber. Shearson Lehman Brothers Inc. trailed far behind in third place.

The managers represent lessees, such as airlines, electric utilities and communications firms, seeking to lease their operating plant or equipment instead of owning it. The managers help find investors interested in becoming lessors, structure financing and place the debt and equity portions of the deals.

A comparable figure for 1984 wasn't available, although IDD estimates leasing placements for 1984 totaled at least $5.6 billion.

Top 10 managers'[1] 1985 lease-related private placements

Manager	Amount ($ mils.)	Market share[2] %	No. of issues
Goldman, Sachs	$2959.1	23.6	19
PaineWebber	2,444.8	19.5	35
Shearson Lehman	1,005.0	8.0	53
First Boston	961.1	7.7	28
Salomon Brothers	952.7	7.6	13
Merrill Lynch	932.9	7.5	18
Citicorp	826.1	6.6	27
Bankers Trust	731.4	5.8	19
1st Chicago Leasing	580.3	4.6	11
Bank of America	413.6	3.3	110

[1] Full credit given to each manager.
[2] Total market was $12.5 billion.
Source: IDD Information Services, New York

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Whichever way the wind blows in leveraged leasing, you can count on Bankers Trust to remain consistently innovative. And consistently a leader.

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U.S. tax proposals . . .

Continued from page 1

Buell T. Adams, treasurer of CBI Industries Inc., Oak Brook, Ill., whose Liquid Carbonic Corp. unit leased its first air separation plant last year, agreed the pending bills will have the biggest general impact on leasing. If the changes are enacted, "leasing will be less attractive to lessors and the cost of leasing is going up," he said.

"I think (the legislation) could have a significant effect," said Franklyn A. Caine, staff vice president and assistant treasurer, RCA Corp., New York, which leases some of its satellites.

But while it's expected to reduce leasing, it won't kill it.

"Under most proposals in Washington, leasing still represents an attractive form of financing for us," Mr. Caine added.

Fear of the bills already apparently has curtailed a lot of tax-driven leasing this year. "There is a definite slowdown in equipment acquisition because of the uncertainty of the tax bill," said Michael Fleming, president, American Association of Equipment Lessors, Arlington, Va., a trade and lobby group.

At Bankers Trust Co., New York, Charles J. Hill, senior vice president, said, "There are only a few transactions in the marketplace right now. Those that are being done are the lower-quality deals."

John L. Steffan, partner, Price Waterhouse & Co., Chicago, was less sure about the pending legislation's impact on leasing. "I think it has slowed down some deals because of the uncertainty . . . But I haven't seen any great effect," Mr. Steffan said.

The expected slowdown depends on when the tax bill would take effect. A bill isn't expected to be enacted until perhaps fall, but the repeal of the investment tax credit could be retroactive to March 1.

Everyone is banking on it not being retroactive to 1985.

Daniel Lief, vice president, Goldman, Sachs & Co., New York, expects the second half of 1986 to be extremely busy in leasing as firms try to conclude deals before the anticipated effective tax date.

But airline leasing may continue to boom.

Edward L. Jensen, assistant general manager, Federal Express Aviation Services Inc., Memphis, Tenn., a Federal Express Corp. unit, expects the airline leasing business to stay healthy.

The Federal Express unit is a consultant to banks and other investors that own, but don't operate, aircraft.

"Aircraft leasing is alive, strong and very healthy," Mr. Jensen said.

He said aircraft leasing dropped briefly late last year as concern mounted about an end of investment tax credits and accelerated depreciation, but quickly picked up.

Federal Express, which leases few of its aircraft, leased three last fall and is considering leasing three more it expects to take delivery on this year from McDonnell Douglas Corp. Mr. Jensen said the aircraft industry leasing pace is ahead of last year.

At International Lease Finance Corp., Beverly Hills, Calif., which specializes in aircraft leasing, Louis L. Gonda, director, doubts tax reform will affect his business.

Despite the growth in the airline industry, the general drop in leasing is having a major effect on capital formation, not just leasing as an alternative financing to owning, argued Mr. Fleming of the American Association of Equipment Lessors.

Ron C. Connolly, executive vice president, Connell Finance Co., West Field, N.J., estimates the implicit interest rate for leasing, now generally 5.1%, would rise to 7.7% under the Senate bill and 9.5% under the House version.

The expected slowdown comes, ironically, as leasing was having its biggest growth.

"Leasing is the largest form of capital formation other than retained earnings," said Geoffrey L. Stringer, president, First Chicago Leasing Corp., a unit of First Chicago Corp. that specializes in so-called big equipment leasing deals of $20 million or more.

Mr. Fleming's association estimates new equipment leases totaled $93.7 billion last year, up from $74.4 billion in 1984. The figures include all types of equipment, regardless of value, much of which isn't leased for tax reasons and probably won't be affected by the pending legislation, according to leasing industry executives.

The so-called big-ticket privately placed equipment leases, valued at $20 million or more, totaled nearly $12.4 billion last year, according to IDD Information Services Inc., New York. A comparable figure for 1984 wasn't available, although IDD estimates leasing placements for that year totaled at least $5.6 billion.

The pending tax bills would affect mostly these large lease transactions.

"These (top-market equipment leases) are almost always done for tax reasons," said Price Waterhouse's Mr. Steffan.

"A lot of people think of leasing as an alternative form of financing, as if it's a secondary form," First Chicago's Mr. Springer said.

"For certain kinds of companies, it's a primary form of financing," because firms can lower their cost of capital by leasing and transferring tax benefits, instead of buying.

"A lot of leasing is done to shift tax benefits from one party (that can't use them) to another (that can)," Mr. Steffan agreed. "The new bills would make tax benefits less lucrative."

Steel firms generally have been leasing equipment recently "because they aren't in a tax-paying position and can't use the tax benefits," said Daryl R. Leehaug, group vice president, Duff & Phelps Inc., Chicago.

They would be among the hardest hit, Mr. Fleming predicted.

As the accompanying chart shows, manufacturing firms accounted for $3.1 billion of the privately placed equipment leases last year, according to IDD.

Utilities were next, with $2.6 billion; natural resource firms, $1.5 billion; and transportation companies, $1.3 billion.

But companies also lease for reasons other than taxes.

"Leasing will still be an ongoing viable business," said First Boston's Mr. Sun. "There are a lot of nice things that go along with leasing," such as being a method of off-balance sheet financing.

Firms commonly lease mainframe computers — even though the cost of buying is often cheaper — to avoid the risk of technological obsolescence, said John J. Vosicky, vice president and treasurer, Comdisco Inc., Rosemont, Ill. Comdisco is the second biggest lessor of mainframes and other computer-related equipment behind IBM Corp.'s own leasing unit.

As he put it, "The value of computer equipment can only go one way — down."

Comdisco deals primarily with Fortune 500 companies; a typical Comdisco lease financing totals $13 million, he said.

He said legislation, while it might not affect lessees, could affect Comdisco's earnings and operations because it uses tax benefits to offset its tax, transferring to other firms those benefits it can't use.

At Goldman, Sachs & Co., New York, David George, partner, said much of its business has been more depreciation-oriented than investment tax credit-oriented. "So those deals would still get done" if, as hoped, the Senate wins over the House in keeping depreciation schedules generous.

Goldman, Sachs handled nearly $3 billion, or 25%, of the privately placed lease financings last year, according to IDD.

Federal Express' Mr. Jensen said the loss of tax benefits might raise the cost of aircraft leasing, but airlines have other lures to leases: to avoid the huge capital outlays; to avoid technological obsolescence; and sales incentives by lessors like McDonnell Douglas' leasing unit.

An idea behind the tax bill is to level the effective income tax corporations pay. Current law offers such benefits as investment tax credits and accelerated depreciation to favor capital-intensive corporations over service firms and other non-capital equipment companies.

Because of the tax benefits, profitable capital-intensive firms can use the tax benefits to lower their effective tax rate below the current general corporate income tax rate of 46%.

The pending bills propose a new corporate rate of 36%. But leasing industry executives argue the proposed rate isn't low enough to offset the loss of such benefits as the investment tax credit. They contend capital investment costs would rise, discouraging industrial expansion and harming job growth and the economy.

Leasing industry executives argue their lobbying isn't selfishly motivated. Because none of the pending legislation is aimed specifically at leasing, they contend the consequence wouldn't be a matter of a firm choosing to buy instead of lease, but whether to invest at all in new capital equipment.

At the American Association of Equipment Lessors, Mr. Fleming said, "We are strongly in favor of the retention of the ITC because of its tremendous incentive to acquire equipment" whether it's leased or bought. ■

1985 lease-related private placements

Industry	Amount ($ mils.)	No. of issues
Manufacturing	$3,136.3	110
Utilities	2,641.6	26
Natural resources	1,446.2	36
Transportation	1,313.7	54
Financial	1,157.1	36
Service	1,068.3	53
Rail/shipping	254.4	11
Retail	78.7	16
Unregulated telephone	20.9	2
Health care	8.2	5
Other*	1,239.2	44
Total 1985	**12,364.6**	**393**
Total 1984	**5,595.7**	**169**

* Includes agency deals and transactions where lessee is unknown.

Source: IDD Information Services, New York

Deals still brew . . .

Continued from page 31

structure of the transaction because it still is being developed. "We haven't gotten very far. Some equity investors have been contacted, but we haven't done any formal proposals as yet," he said.

The success of Public Service of New Mexico's first sale-leaseback was a catalyst in El Paso's decision to go ahead with its deal.

Public Service of New Mexico sold 72% of its 10.2% stake in Palo Verde Unit 1 to Chrysler Capital Corp., Detroit; Drexel Burnham Leasing, New York; and Mellon Financial Services, Pittsburgh. They, in turn, are leasing the facility back to the utility.

The investors financed the deal with about $70 million in equity and $255 million in debt.

Through the sale-leaseback, Public Service of New Mexico reduced to $40 million the amount of revenue it has to generate from consumers in the first year of the unit's operation to get a full return on its investment in the plant, said Martin Clifton, corporate vice president-financial planning. That represented a 50% drop in its first-year revenue requirement had the utility continued to own all the unit. Over the 40-year life of the project, nominal savings to consumers should reach $372 million, Mr. Clifton added.

At the same time, proceeds from the sale-leaseback will enable the utility to reduce its debt exposure and interest expense. Up to $250 million of the proceeds have been earmarked for redeeming retiring outstanding bonds, Mr. Clifton said.

The utility's second sale-leaseback to investors of its 10.2% interest in Palo Verde Unit 2 is expected to generate nominal savings of $535 million over that unit's 40-year life, he added.

The $450 million deal will be structured similar to the utility's first transaction. Plans are to complete within 90 days after the nuclear facility goes into operation this month to ensure that investment tax credits can be sold to investors.

Mr. Clifton said the utility missed the 90-day deadline in structuring the first deal. As a result, the tax credits couldn't be passed to the three lessors.

In addition, the utility is hoping to complete the sale and leaseback of its remaining $125 million stake in Palo Verde's first unit by midsummer. The New Mexico utility's Mr. Starnes said his company has applied to the state's Public Service Commission for permission to sell that stake to an existing subsidiary, Sunbelt Mining Co.

In the meantime, Public Service of New Mexico is working with Kidder on a roughly $350 million public offering of debt due to come to market sometime in the second quarter.

The lion's share of the offering's proceeds will go to refund the $255 million debt portion of the sale-leaseback completed last year, said Bruce Walenczyk, vice president at Kidder. The remainder will provide the leveraged portion of $125 million sale-leaseback under way now.

Plans on the initial sale-leaseback were to fund the debt portion of the deal with a public offering of serial bonds with maturities ranging from one to 29.5 years. The offering's structure was designed to take advantage of the steep yield curve existing at the time and provide a lower blended interest rate to the lessors, Mr Walenczyk said.

To avoid registration delays, the participants opted for interim debt financing to get the deal done by year end, he said. Since then, the yield curve has flattened out, making the public offering's original structure less appealing.

"We don't know how we'll structure the offering now," Mr. Walenczyk said. "That will be a function of market conditions when we're ready to do the deal."

Plans are to fund the leveraged portion of the $450 million sale-leaseback for Public Service of New Mexico's interest in the second unit through a public debt offering as well. The debt portion should account for about 80% of sale price.

While the largest deals now in the market represent sale-leasebacks of utility and manufacturing plants, investors also are showing interest in other types of equipment leasing transactions.

Deutz-Allis Credit, a captive finance subsidiary of Deutz-Allis, is nearing completion of its second quasi-asset-backed lease deal as part of the company's efforts to offer attractive financing of farm equipment to the farming community.

Deutz-Allis, a manufacturer and importer of tractors and other farm machinery, recently tested

Continued on page 36

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Top 10 lease . . .

Continued from page 31

GATX Corp., Chicago, and leased it back. It was the first time it leased such a plant rather than own it, he said.

Like other lessees, Mr. Adams said CBI's Liquid Carbonic unit chose to lease because CBI isn't paying taxes and was unable to use the tax benefits derived from the investment tax credit and speedier depreciation.

By selling the plant, "we can sell the ITC and depreciation to someone who can use it," he said. In addition, he said CBI was looking for a source of off-balance sheet financing to avoid nearing a debt-load restriction imposed by loan covenants. The 15-year operating lease appears in CBI's financial statements only as a footnote.

By leasing instead of borrowing to buy, Mr. Adams estimates CBI's implicit interest charge at 5% instead of 8%.

Though it wasn't among the biggest privately placed leases of the year, Mr. Adams said the Liquid Carbonic lease exemplified the notion that leasing can finance anything, rather than traditionally leased generic, transportable assets.

Typically, in a sale-leaseback, about 20% to 30% is financed with equity and the rest with debt. The firm or group of firms wanting the tax benefits buys the equity part, while debt is financed by other parties, with recourse in the event of a default to the equipment or plant rather than to the lessor.

Among 1985's biggest leasing deals:

• Tucson Electric's lease deal technically was the biggest of the year, though the transaction is subject to approval of Arizona regulators. Financing was arranged for $900 million, but the utility expects the final figure to come to $850 million after construction is completed in 1989.

Units of IBM Corp., Armonk, N.Y.; Philip Morris Inc., New York; and Emerson Electric Co., St. Louis, bought the equity part of the deal.

• The sale by Deseret Generation & Transmission Cooperative, Sandy, Utah, of its 44% interest in the Bonanza power station for $644.8 million was the second biggest leasing deal of the year. Shell Leasing Corp., a unit of Shell Oil Co., Houston, was the sole equity investor, paying about $306 million. The rest of the financing for the Bonanza plant, near Vernal, Utah, came from the public sale of bonds.

A public offering for debt "is relatively unusual," said J. Scott McGrane, first vice president, PaineWebber Inc., Deseret's coagent which arranged financing with Salomon Brothers Inc. "It's the third time that's happened for an electric utility generating station."

• Oglethorpe Power Corp., Atlanta, recorded a $79 million gain when it sold its 60% interest in the Scherer coal-fired Unit 2 generating plant for $395 million four investors, said Greg Jones, media relations representative. The four investors are Chrysler Financial Corp., Detroit; Ford Motor Credit Co., Dearborn, Mich.; HEI Investment Co., Houston; and IBM Credit Corp., Stamford, Conn.

Besides the profit, he said Oglethorpe, a taxable cooperative that supplies power to other Georgia electric cooperatives, chose to lease because its earnings were too small to take full advantage of tax benefits of owning.

Mr. Jones said Oglethorpe estimates it reduced its implicit interest cost by leasing instead of borrowing to own by three percentage points, to 8%.

He said Oglethorpe used $362 million of the proceeds of the sale to pay off a Rural Electrification Administration 11% guaranteed loan from the Federal Financing Bank to build the plant near Macon, Ga., which went into service in February 1984.

The rest of the proceeds are being used to pay capital gains tax on the sale and other costs associated with the lease financing, he added.

• Portland General Electric Co., Portland, Ore., recorded an immediate $100 million gain when its Fale Safe Inc. unit sold its Boardman generating station in Boardman, Ore., for $233 million, according to Lindsay A. McManus, vice president, First Boston Corp., New York. First Boston was Portland General's agent and arranged the lease financing.

General Electric Credit bought the plant and leased it back to the Portland utility. GECC provided $44.6 million for the equity part of the financing, while First Boston sold the debt to other groups.

• Santa Fe International Corp., Alhambra, Calif., sold and leased back for 22 years a geothermal plant, fueled by geysers, north of San Francisco. The plant was sold for $210.5 million. Tri-Continental Leasing Corp., Paramus, N.J., a unit of Bell Atlantic Corp., Philadelphia, bought the plant, putting up $66.5 million in equity, while the $154 million in debt was financed through three private offerings.

Pacific Gas & Electric Co., San Francisco, has a contract to buy the power produced by the 80 megawatt plant for a few years beyond the life of the lease.

• RCA Corp., New York, will receive an undisclosed gain from selling its Satcom K-2 satellite in a $314 million leveraged lease financing to a group of five utilities, the equity participants. They put up $62.7 million, while a group of RCA's banks loaned the other $251 million in an installment note due in February.

PaineWebber Inc. was RCA's agent, helping to arrange the financing for the satellite put in orbit in November by the space shuttle Atlantis.

By using the installment sale agreement, RCA was able to delay recognition of the taxable gain until 1987, when it might enjoy lower tax rates due to tax law changes now pending in Congress.

The gain arises because a properly positioned orbiting satellite is worth more than it cost to build, reflected on a firm's balance sheet.

• GTE tried a similar financing with its Spacenet 3. It had arranged to sell the satellite for $248.4 million, also to a group of utilities, to realize a gain. But the cost of the satellite to GTE was apparently less; it was insured for $85 million by Ariel Syndicate of Lloyd's of London.

But GTE had to refund the lease financing after the satellite was destroyed in September.

"GTE had to buy back the smoldering ruins," said D. Barry O'Connor, managing director, PaineWebber Inc., New York. "It was one of the shortest financings in history."

GTE, however, in another Ariane launch in 1985, successfully complete another satellite lease financing of about $205 million, which fell short of making the Top 10.

• To help finance its leveraged lease, Basin Electric Power Cooperative, Bismarck, N.D., arranged the first commercial paper financing, backed by its credit as lessee, rather than the typical bank letter of credit. St. Paul Bank for Cooperatives, St. Paul, Minn., was unable to fund all of the $217 million debt portion of the total $620 million lease financing for the Antelope Valley station Unit 2 in Beulah, N.D.

So working with its agent, PaineWebber, Basin Electric, arranged the $54 million commercial paper facility.

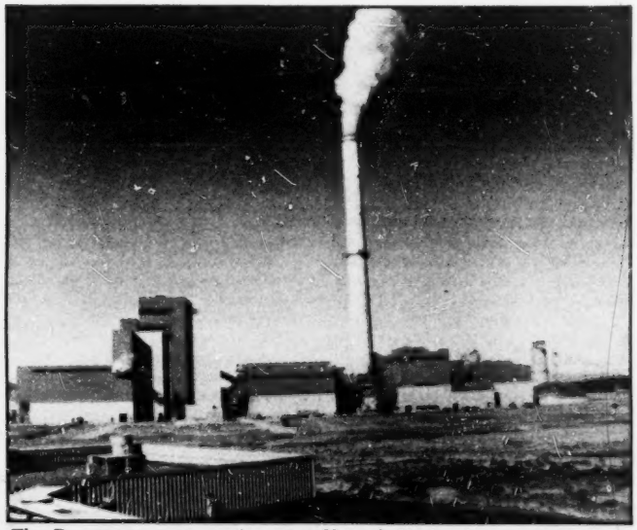
• Montana Power Co., Butte, Mont., sold its 30% interest in Colstrip unit 4 for $292 million. Drexel Burnham Lambert Leasing and SGE Associates, a partnership of GECC and Shell Leasing, invested $75 million for the equity portion.

The rest of the $217 million financing came from the sale of secured notes (*Pensions & Investment Age*, Feb. 3). ■

Largest privately placed plant or equipment leases of 1985

Lessee and leased plant/equipment	Total financing ($ mils.)	Buyer(s)	Lessee agent(s)
Tucson Electric Power Co. Springerville coal plant[1]	$900	Units of IBM, Philip Morris, Emerson Electric	Goldman, Sachs
Deseret G&T Co-op Bonanza plant (44% interest)	644.8	Shell Leasing	PaineWebber, Salomon Bros.
Basin Electric Power Co-op Antelope Valley Station Unit 2	620	Beatrice Financing, Chrysler Financial, Dart & Kraft Financial, First Chicago Leasing, J.C. Penney, Saks Fifth	First Chicago Leasing
Oglethorpe Power Corp. Scherer plant Unit 2 (60% interest)	395	Chrysler Financial, Ford Motor Credit, HEI Investment, IBM Credit	Merrill Lynch Capital Mkts.
RCA Corp. Satcom k-2	314	NA	PaineWebber
Montana Power Co. Colstrip Unit 4 (30% interest)	292	Drexel Burnham Leasing, General Electric Credit, Shell Leasing	Goldman, Sachs
GTE Corp. Spacenet 3 satellite (destroyed)	248.4	NA	PaineWebber, Salomon Bros
Fale Safe Inc., unit of Portland General Electric Co. (15% interest)	233	General Electric Credit	First Boston
Cogen Lyondell Inc., cogeneration plant unit of PSE Inc.	222.5	General Electric Credit	Donaldson Lufkin & Jenrette
Santa Fe Int'l., geothermal plant	210.5	Tricontinental Leasing (Bell Atlantic unit)	First Boston

[1] Transaction not complete, subject to state regulatory approval
NA: not available
Sources: IDD Information Services, lessees, and other firms



The Bonanza power station near Vernal, Utah, above, was the subject of the second biggest leasing deal of 1985.

$2,200,000,000

Leasing and Secured Asset Financings

During 1985 the undersigned acted as financial advisor, agent or principal on twenty-two transactions for companies with credit ratings ranging from AAA to CCC and involving leasing or secured asset financings of a broad range of equipment and real estate, including transportation equipment, commercial office space, electric generating facilities, steel manufacturing equipment, warehouses, mining facilities and equipment, high technology equipment, retail stores, alternative energy facilities, industrial properties and satellite transponders.

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Money movers

Southwestern Bell Corp.

ST. LOUIS — Southwestern Bell Corp., with about $4.5 billion in pension assets, has hired its first real estate managers for a total initial allocation of $225 million.

Mary Ann Devine, district manager-pension fund, said Heitman Advisory Corp., Chicago, was given $100 million; Boston Co. Real Estate Counsel, Boston, $75 million; and John McMahan Associates Inc., San Francisco, $50 million.

All of the money will be run in separate accounts that were funded with money previously earmarked for real estate, Ms. Devine said. She and Janell Manley, staff manager-pension fund, conducted the search with Buck Pension Fund Consultants, New York.

Southwestern Bell has a small amount in real estate through the Telephone Real Estate Equity Trust, set up by American Telephone & Telegraph Co. before it spun off its seven operating companies.

American Can Co.

GREENWICH, Conn. — The nearly $1 billion American Can Co. pension fund hired American Capital Management, Houston, to manage $20 million in fixed income, said E.C. Ecker, pension investment officer.

American Capital is a subsidiary of American Can, but will manage money for other clients as well, Mr. Ecker said. It was funded from cash flow.

Georgia-Pacific Corp.

ATLANTA — Georgia-Pacific Corp. hired Wells Fargo Investment Advisors, San Francisco, to run $20 million in its Extended Market index fund, said John Stettler, director-employee benefit investments at Georgia-Pacific.

The investment represents equal allocations from the company's $280 million pension plan and its $195 million profit-sharing plan, he said.

He said the assets came from the sale of Standard & Poor's 500 stock index futures contracts.

"It was a good complement to our S&P 500 position," said Mr. Stettler, adding the move broadens the funds' equity exposure to smaller-capitalization stocks. The equity portion of the total portfolio was unchanged.

Ennis, Knupp & Gold, Chicago, was the consultant used in the search.

Mack Trucks Inc.

ALLENTOWN, Pa. — The $450 million Mack Trucks Inc. pension fund hired Harris Trust and Savings Bank, Chicago, and First Pacific Advisors Inc., Los Angeles, while terminating another manager, said Paul McKiel, vice president-trust assets.

Mack assigned $10 million to Harris' commingled convertible fund, Mack's first convertible portfolio, he said.

Also, it assigned $20 million to First Pacific to run in equities.

He said the money for the new hires, which were selected without aid of a consultant, came from a terminated manager.

Tektronix Inc.

BEAVERTON, Ore — The $403 million Tektronix Inc. pension fund hired Morley Capital Management Inc., Lake Oswego, Ore., to take over the management of an $85 million portfolio of guaranteed investment contracts.

The GICs previously were handled in-house.

Blue Cross & Blue Shield

CHAPEL HILL, N.C. — Blue Cross & Blue Shield of North Carolina Inc., with $380 million in tax-exempt general operating funds, has picked two managers to run $70 million in assets, said Walter W. Baucom, treasurer.

Standish, Ayer & Wood Inc., Boston, will run a $60 million fixed-income account, while Delaware Investment Advisers, Philadelphia, will manage a $10 million equity portfolio. The managers were selected because their investment styles complement existing managers and their performance records are outstanding, Mr. Baucom added.

An undisclosed manager was terminated, not because of performance, but because its style no longer fit in, he said.

Both Standish, Ayer and Delaware will protect capital in down markets for the risk-averse Blue Cross fund. The addition of Delaware will boost Blue Cross' equity allocation to $35 million from $25 million.

The fund's other equity manager is Thompson, Siegel & Walmsley, Richmond, Va., while current bond managers are Manufacturers Hanover Investment Corp., New York, and Gardner and Preston Moss, Boston. Blue Cross manages its cash internally.

Peat, Marwick, Mitchell & Co., New York, was the consultant.

Columbus & S. Ohio/Pipefitters

BALTIMORE — The $225 million Columbus & Southern Ohio Electric Co. and the $17 million Steam & General Pipefitters Local 438 pension funds have shifted their equity accounts to Mount Vernon Associates from recently acquired Redwood Capital Management Inc.

Dale Troll, administrator for the Steam & General Pipefitters fund, Baltimore, said it was shifting its $2 million equity account to retain the firm's investment philosophy.

Four of the five portfolio managers, including Redwood's former president, William J. Heffner, left to set up the new firm after their offer to acquire the money management unit from Maryland National Bank was rebuffed.

Daughters of Charity

ST. LOUIS — The $52 million total Daughters of Charity Health Systems Inc. pension fund hired The Boston Co., Boston, to manage an active core equity portfolio.

The fund's initial commitment totaled $24 million and the portfolio will be managed by the Boston Co.'s Structured Investment Products Division.

Western Union Corp.

UPPER SADDLE RIVER, N.J. — Western Union Corp., with about $49 million in its savings plan, purchased a guaranteed investment contract from New England Mutual Life Insurance Co., Boston, according to Edwin M. Higgins, president of Higgins Associates, the company's consultant.

The GIC purchase included an initial investment of $7.5 million with a one-year window provision for further contributions. The contract also contains a two-year accumulation period followed by a two-year payout period.

The GIC will earn interest at a rate between 8% and 9%, Mr. Higgins said.

Uniformed Firefighters Fund

NEW YORK — The roughly $38 million Uniformed Firefighters Compensation Accrual Fund hired Unity Management Inc., Lake Success, N.Y., to manage an undisclosed amount in a balanced account.

Missouri State Employees

JEFFERSON CITY, Mo. — In a move to control the cost of its $15 million medical care plan, the Missouri State Employees' Retirement System recently selected Investment Capital Management Corp., Chicago, to manage the plan fund, confirmed Mary-Jean Hackwood, executive director of the retirement system.

The Chicago-based management firm was chosen to handle the fund because "it met our needs — both their style of management and our servicing requirements," Ms. Hackwood said.

Investment & Capital Management Corp. will manage a limited-maturity, high-quality, fixed-income portfolio.

Anderson Clayton & Co.

HOUSTON — Anderson Clayton & Co., hired RepublicBank Dallas as trustee for its new leveraged employee stock ownership plan, said Mark Addicks, manager-public relations at Anderson Clayton.

Mr. Addicks would not disclose the amount of assets in the ESOP, but said the plan will own about 750,000 shares of common stock, or 25% of the company. He added RepublicBank has hired Houlihan, Lockey, Howard & Zukin Inc., Los Angeles, as an evaluation consultant.

Georgia State Teachers' Fund

ATLANTA — The $5.5 billion Georgia State Teachers' Retirement Fund has placed $110 million in an index fund modeled on the Standard & Poor's 500 stock index, said Graham R. Lynch, director-division of investment services.

The fund, which is part of the $8 billion Georgia State Retirement Systems, needed to expand its stable of four equity advisers. Instead of hiring a new one, though, the fund created the internally managed index fund with the help of Wilshire Associates, Santa Monica, Calif., Mr. Lynch explained.

The retirement system limited the size of the index fund to no more than 350 stocks. In addition, Georgia law requires the fund invest in American companies that have paid a dividend in at least three of the past five years.

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Big deals still brew . . .

Continued from page 34

the waters for the program with a two-stage, $20 million deal. The transaction it is working on will total between $50 million and $100 million, said Leslie Wilson, executive vice president and general manager of the credit subsidiary.

The private placement will include a pool of five-year leases on new equipment that will be delivered to customers this year. Richard Sun, vice president at First Boston Corp., agent on the deal, said the leases will carry a 9.7% lease rate and will give farmers the option to buy the equipment at the end of the lease at 15% of its original cost. That 15% purchase option is calculated into the 9.7% interest rate, Mr. Sun said.

The deal also will include a pooled letter of credit against losses on a percentage of the deal. The annual loss rate on these types of leases is less than 1%, Mr. Sun noted. Although what percentage of the transaction will be guaranteed by the letter of credit was still being negotiated, he estimated it would be around 20%.

Also still under negotiation are the up front and ongoing service fees that Deutz-Allis will get for administering the lease portfolio on behalf of investors.

The 9.7% rate on the leases is more than 400 basis points lower than farmers would get through other equipment financing sources, Mr. Sun said. Investors are willing to accept the lower rate in exchange for receiving the investment tax credits and depreciation associated with the leases.

Deutz-Allis has turned to the pooled financing vehicle primarily to provide an attractive equipment financing alternative, through its dealers, to the troubled farm community, Mr. Wilson said.

"Farmers used to be able to enjoy the tax benefits of owning equipment," he said. "But their thin tax position these days means that those benefits often exceed farmers' needs."

Deutz-Allis Credit previously offered lease financing to customers itself, carrying the tax-oriented leases for its own account. However, Deutz-Allis, formerly Allis-Chalmers Corp., has less need for the investment tax credits associated with the leases since it was acquired by Klockner-Humboldt-Deutz A.G. last year. "A sizable amount of tax benefit carry forwards came along with the acquisition," Mr. Wilson said.

The new lease finance program — an off-balance sheet funding method for Deutz-Allis — fits into its current corporate financing game plan.

"We've decided we want to do more off-balance sheet funding generally as a means of reducing leverage and improving our capital structure," Mr. Wilson said.

He said he is looking to the private vehicle as an ongoing lease financing program. He acknowledges, however, that how long-lived the program will be largely hinges on how tax reform shakes out in Washington. ■

Dynamic . . .

Continued from page 3

stocks; now, portfolio insurance. "The best ideas are those that few people hear about," he said.

Mr. Tokar said he doesn't see anything wrong with protecting gains, but believes dynamic hedging is not the only way to do it. Diversification is itself a form of protection, and his firm's pension fund is well diversified, he said.

LOR's Mr. Leland and Mark Rubinstein, both professors at the University of California Business School, Berkeley, developed the theories surrounding dynamic hedging in the late 1970s and formed LOR with John O'Brien in 1981. Messrs. Leland and Rubinstein are managing directors of the firm, while Mr. O'Brien is chairman and chief executive officer.

At the end of March, the firm and others using its technology were applying the strategy to about $6.1 billion in assets, said Larry Edwards, president. Since then, $400 million to $500 million probably has been added, he said.

Dynamic hedging managers that don't use the LOR technology probably are implementing programs for at least $2 billion in assets, according to estimates by industry experts.

This makes for a total of $8.5 billion being dynamically hedged, up from estimates of $6 billion last fall and $200 million two years ago.

Still, the strategy definitely has its critics. A vocal one is Richard Brignoli, president and chief executive officer of Brignoli Models Inc., which develops investment models for equities and derivative instruments, and general partner of Brignoli, Curley & Roberts Associates. Both firms are in New York.

"It's not insurance per se," Mr. Brignoli said of portfolio insurance. "At best, the people that are buying this assurance are self-insuring, which is no insurance at all."

The risks of the equity market are not able to be pooled, so no investor can take on part of another's risk, he said.

Mr. Leland agreed the product does not amount to risk pooling. But he said, "It is insurance in the sense that your loss is limited on the downside, and you capture the gain less the premium on the upside . . . It's insurance in exactly the form that buying a protective put option on an individual stock is insurance on that stock."

Mr. Leland also contended the product is not self-insurance, if self-insurance is defined as setting aside an amount of money each year and hoping it will build up enough to cover the losses that come at some time. With dynamic hedging, losses will be covered whether they occur one year or 50 years from now, he said.

Mr. Brignoli said another problem is that investors using portfolio insurance over a long time horizon — say, five years — still can report substantial losses between the beginning and end of that horizon. "It doesn't solve the problem of underperforming the market," he said.

Mr. Leland replied, "You do have protection prior to the end, but the protection is less than it is at the expiring moment. If that really disturbs people, more interim protection can be designed into the system."

Another criticism from Mr. Brignoli is that the system calls for buying futures when the market is on the way up and selling them when it's going down. "That costs money," he said.

Mr. Leland said whether this is good or bad depends on whether the market continues in the direction it was headed. "If the market continues to go up, we, of course, with hindsight look like geniuses," he said. "If we sell and the market continues to go down, again we look like geniuses."

However, markets don't always go straight up or down, Mr. Leland said. If an investor buys the futures in a rising market that quickly turns into a falling one, and then sells out, the investor has paid a premium, he said. "That is the place where you have paid the price of the insurance," he said. Portfolio insurance does not promise something for nothing, he emphasized.

Mr. Brignoli said any strategy that is most useful in long trends isn't really useful, because no one is able to predict long trends.

He also charged portfolio insurance will create ever-wider swings in the financial markets as an increasing number of investors use it. It also will become increasingly expensive to implement, he said. "I sincerely doubt that it will be able to be implemented with any large pools," he said.

Mr. Leland replied, "My position is not everyone can simultaneously follow the same dynamic strategy." In every sale or purchase by a dynamic hedger, there must be someone on the other side of the transaction, he said. "In fact, portfolio insurers may be trading with portfolio rebalancers," he said.

If markets became highly volatile, which is possible, rebalancers or other candidates for the flip side of dynamic hedgers' transactions likely would see an opportunity to make a profit, Mr. Leland said. Then, with supply and demand in line with each other, volatility would decrease, he said.

Mr. Brignoli contended, however, that it will be harder for dynamic hedgers to find the other side of their trades in a down market than in an up one.

Still, Mr. Leland said, those who follow a dynamic hedging strategy and those who oppose it are natural trading partners.

"Not everyone has the same investment objectives or requirements," he said. He said portfolio insurance is highly appropriate for investors with clear-cut fiduciary responsibilities that limit their ability to take downside risk.

Others interviewed disagreed slightly, saying it likely is appropriate for some pension funds, but not others. "It's a useful tool for a company that has some very special needs for its pension fund," said a Southern corporate pension executive, who asked not to be identified.

Such companies would include Denver-based Manville, which is in reorganization under the Federal Bankruptcy Act and could not bear market losses in its pension fund, the executive said. But companies that wouldn't suffer severe financial impact probably would do better to look to the free market, he said.

His firm has looked at portfolio insurance, but does not plan to adopt it in the near future. Before making such a decision, he said, he would like to see how it performs in a down market.

Halliburton's Mr. Duffield said his firm may or may not decide that portfolio insurance could be useful. However, the fact that Halliburton's primary retirement plan is a defined contribution plan makes it worth considering, he said. "Certainly, volatility is a key consideration for defined contribution plans," he said.

TWA already has applied the strategy to a defined contribution plan (*Pensions & Investment Age*, Nov. 25).

Gates, like TWA and Manville, is a satisfied user of LOR's portfolio insurance strategy. "It's worked very much as it was predicted it would work," said Clayton Hill, director of corporate insurance and employee benefits. Gates applies the strategy to the $135 million equity portion of its $270 million pension fund.

It has been using the strategy for about two years. During that period, Mr. Hill said, it has had to apply the hedge only twice, when the generally bullish market took brief bearish turns.

"We knew going in that this would be the expensive part of a fiduciary hedge program," he said. 'But you never know when a downward move would be the one that precipitates a long downward cycle . . . If you're a fund manager and you lived through the '74 market slide, you know it happens rapidly and the individual investment managers get caught in the slide."

In a bull market, portfolio insurance is useful for locking up gains, Mr. Hill said. As its equity portfolio has increased in value, Gates has raised the amount covered by the program, he said.

Also, because of the dynamic hedging program, Gates' equity managers have been able to be invested to a greater degree than they might have been otherwise.

Manville also has used the program to lock up gains and to increase its commitment to equities. As a matter of fact, it has eliminated fixed income from its pension fund, except in special situations (*P&I Age*, March 3).

An East Coast corporate pension executive, who asked not to be identified, said the concern for locking up gains has led his firm to consider implementing portfolio insurance, but not without reservations.

"It's not a panacea," he said. "There are costs involved which may not be readily apparent at first blush."

Still, said Gates' Mr. Hill, "We think the protection is worth the price." ■

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Public funds . . .

Continued from page 3

The leader in number of accounts gained was Bankers Trust Co., New York, with nine master trust or custodial accounts. Its Investment Management Group gained two discretionary management accounts, but they were counted separately from the master trust and custodial accounts.

Neuberger & Berman Pension Management, New York, gained five accounts, and five firms tied with four new accounts each.

Managers losing large or numerous accounts during the quarter included Gardner and Preston Moss Inc., Boston, and Redwood Capital Management Inc., Baltimore.

The $4.7 billion Arizona Public Employees' Retirement System terminated Gardner and Preston Moss, which ran a $470 million balanced portfolio for the fund. The fund's investment advisory council found the firm's style too conservative, an official said. The assets were moved to Wells Fargo and to INVESCO Capital Management Inc., Atlanta, but the amount allocated to each was not available.

Executives at four pension funds said they are moving assets from Redwood, which had four of its five investment professionals depart to set up their own firm. The new firm, Mount Vernon Associates, Baltimore, received an allocation from at least two of the funds — Columbus & Southern Ohio Electric Co., Columbus, Ohio, and Warner-Lambert Co., Morris Plains, N.J. ■

NOTE

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C2710-2

AT&T nets $200 million by adopting FASB 87

By Richard J. Gillespie

NEW YORK — American Telephone & Telegraph Co., with a pension plan that is more than $10 billion overfunded, boosted first-quarter pre-tax earnings by $200 million, or 9 cents per share, with the adoption of Financial Accounting Standards Board Statement 87.

The AT&T move followed a similar one by IBM Corp., Stamford, Conn., which analysts estimate boosted its first-quarter earnings by as much as $100 million or 10 cents per share.

Analysts raised the possibility that the first-quarter earnings boost from the accounting change may not be the last for AT&T.

Rather than merely report significantly lower contributions, they said, AT&T could also adopt other changes to significantly reduce actual pension fund contributions.

AT&T paid $174 million in contributions to its fund for the first quarter using its traditional method. By adopting the new reporting method under Statement 87, it decreased pension costs by $200 million.

The discrepancy results from changes in AT&T's pension fund accounting disclosure wrought by its adoption of Statement 87.

Under Statement 87, AT&T gets to amortize its actuarial surplus; Statement 87 also calls for the use of the unit credit method for calculating liabilities while AT&T uses the aggregate cost method in

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Pensions & Investment Age

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Funds watch as others try program trades

By Trudy Ring

Most pension funds are sitting on the sidelines while other investors — including cash managers and brokerage firms — engage in program trading, the splashy new market play involving arbitrage.

Corporate pension executives and money managers cite several reasons they have shied away from program trading:

- Pension funds have long-term needs, and don't have idle cash on hand to participate in the market play.
- Just as some of them got interested, spreads between stocks and derivatives narrowed as more players entered the game.
- Program trading requires intensive monitoring and incurs additional transaction costs at a time when many fund executives are trying to reduce those costs.

Traders using this type of arbitrage seek to take advantage of the spreads between the prices of stocks and the prices of stock index futures or options. For instance, when the futures are overvalued in relation to the market, they will buy stocks that resemble the Standard & Poor's 500 stock index and sell short the futures based on that index.

In doing so, they can lock in a risk-free rate of return that may be 100 or more basis points higher than rates on short-term fixed-income instruments, such as Treasury bills. However, experts say spreads between stocks and the derivative instruments are narrowing, making the arbitrage play less profitable.

Photo by Arnie Adler

Program trades often dominate equity trading-floor activity.

Relatively few pension funds have used these trades, but several are looking at them. The trades more commonly are used in corporate cash management or by brokerage houses trading for their own accounts.

K mart Corp., Troy, Mich., uses stock index arbitrage in its 501(c)9 medical trust and is studying its use for the pension fund, said John Steinbach, assistant treasurer.

stridge Capital Management Inc., Los Angeles, manages the K mart $30 million medical trust.

"We've been involved with the firm for about three months now, and they've had a program on most of the time," Mr. Steinbach said. "We've been very pleased with the return." The return has been 200 to 300 basis points higher than that of T-bills, he said.

K mart has not used arbitrage programs in its $800 million pension fund, largely because its needs are longer term than those of the medical trust, Mr. Steinbach said. He added he is studying many uses of stock index futures and options for the fund and is not ruling out anything.

Indeed, the fact that pension funds have long-term needs has held down their participation in these trades. Martha Binzel, senior manager-benefit plans investment at Sara Lee Corp., Chicago, said Sara Lee's pension fund doesn't have the cash necessary on a permanent basis to use arbitrage programs.

"Pension funds don't tend to carry a lot of cash, and their investments tend to be longer term in nature," said R. Sheldon Johnson, a principal of Morgan Stanley & Co., New York.

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Carpenters hammer at American Express

By Ed Christman

NEW YORK — The head of the United Brotherhood of Carpenters & Joiners is urging local union pension funds to avoid using American Express Co. and such subsidiaries as Shearson Asset Management Inc., a money manager.

Patrick J. Campbell, general president of the carpenters, said in a union publication that an investment adviser "who either directly or through subsidiary operations refuses to work with our members does not deserve our business."

His letter in "Carpenter" magazine said American Express and its subsidiaries benefit "handsomely from the management of union pension funds, while at the same time they engage in the develop[illegible] of construction using non-union labor contractors."

At issue is a credit card facility being built by American Express in Greensboro, N.C. Carpenters' union officials allege union contractors were shut out in the bidding process to be general contractor.

The April issue of the magazine contained a two-page article detailing the dispute and a profile of the various operations of American Express and how it "reaps considerable revenues" as investment managers of building trades union pension funds.

It also called for members to provide information on the construction activities of American Express and subsidiaries, and information on existing financial relationships with the company.

No union pension fund appar-

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Waiver, restructuring eyed

Western Union falters

By Joel Chernoff

UPPER SADDLE RIVER, N.J. — Western Union Corp., weighed down by heavy debt obligations and strapped for cash, is trying to avert bankruptcy by such measures as a pension contribution waiver and the restructuring of most of its equity and debt obligations.

Facing a June 30 deadline from its banks, the severely troubled telecommunications firm has proposed merging itself into its subsidiary, Western Union Telegraph Co.

In the process, it will bolster its strained cash flow by stretching debt maturities, swapping new debentures for old ones, paying sinking fund payments with the old securities and issuing $200 million in junk bonds.

While the recapitalization plan may give the company a reprieve from its immediate obligations, analysts question whether the company will survive.

"This plan will only solve one part of the problem," said John Bain, senior vice president for Shearson Lehman Brothers Inc., New York. Western Union still needs "a business plan," he said.

"I wouldn't want to lend them money," said Harry Rosenthal, associate director at Bear, Stearns & Co., New York.

Western Union's plan hinges on a number of unknowns, including whether it will receive a government waiver of a $52.5 million contribution to its ill-funded pension plan, and whether it can win an appeal of a $36 million antitrust judgment rendered against the company last November.

The Pension Benefit Guaranty Corp., which reviews major requests for funding waivers, will "vigorously oppose" granting the pension defer-

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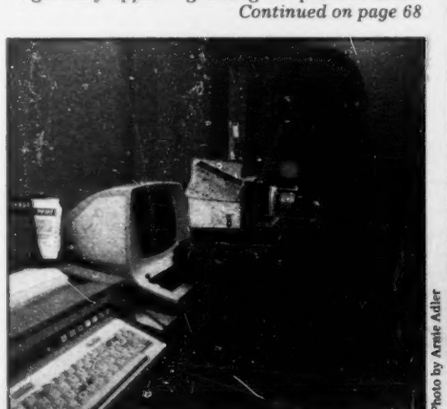

Photo by Arnie Adler

Western Union is trying to avert bankruptcy.

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Fund's insurance held up

Philadelphia Gas Works postpones eight hirings

By Chuck Paustian

PHILADELPHIA — The inability to secure fiduciary liability insurance may prove costly to the $156 million Philadelphia Gas Works Retirement Reserve Fund, said Curtis O. Townsend, deputy director of finance-pension fund asset manager for the city.

The hiring of as many as eight investment managers has been postponed until the fund has been able to secure insurance for Mr. Townsend and members of the Sinking Fund Commission, who oversee the investment of the pension assets.

Philadelphia Gas Works, owned by the city, is looking to restructure its portfolio in an attempt to reduce its $15 million unfunded liability, Mr. Townsend said.

He added the fund probably will have to pay a high premium for the insurance once it is obtained. The delay in hiring the managers, however, may cost the fund millions in opportunity costs given current market conditions.

Mr. Townsend said the fund, which is about 20 years old, historically had followed a very conservative investment strategy.

The approximate historical asset mix of the fund was 36% bonds, 35% cash, 19% government securities and 10% equities.

"Since the fund has never been drawn upon, and it is not likely to be drawn upon until 1991, I feel we can become more aggressive," he said.

Mr. Townsend said he is looking to hire between four and six equity managers, for about $12 million to $14 million each and two or three debt managers, for about $15 million each. He added the search for the managers began at the end of February.

He also said he would like to invest about $10 million to $15 million in alternative investment vehicles, such as real estate or venture capital, to improve the returns of the fund.

When he is finished, Mr. Townsend said he would like the asset mix to be about 50% equities, 40% bonds, 8% alternative investments and 2% cash.

He said if the fund could not obtain the proper insurance coverage, he might have to call an emergency meeting of the board of trustees.

"If we don't get (the insurance coverage), I think it will pose some problems," Mr. Townsend said.

On April 21, he said the fund was close to obtaining an insurance package to cover all those associated with the fund. The next day, however, he said the fund was unable to close that deal because the insurance carrier would not agree to provide the insurance unless another carrier was involved.

Mr. Townsend declined to name the insurance carrier.

The current environment in both the stock and bond markets places an even greater need to secure the insurance promptly, so the fund can hire the managers and invest its assets.

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> ***"Since the fund has never been drawn upon, and it is not likely to be drawn upon until 1991, I feel we can become more aggressive."***
> **— Curtis O. Townsend**

DOL says Graniteville diverted plan surplus

By Joel Chernoff

AIKEN, S.C. — The Department of Labor is suing eight current and former officials of Graniteville Co. for failing to press the company to hand over to its new retirement plan some $27 million in surplus pension assets from two terminated plans.

The department alleges the company diverted to corporate coffers an amount equal to surplus assets that was "irrevocably committed" to a new Graniteville employee stock ownership plan, later converted to a retirement savings plan.

The excess assets were used to reduce corporate debt incurred in the July 1983 takeover of the textile company in Graniteville, S.C., by Southeastern Public Service Corp., the suit alleges.

Southeastern is controlled by Miami financier Victor Posner.

The eight corporate and benefit officers, members of a committee that administers the plan, violated their fiduciary duties when they failed to try to obtain control of the assets for the plan, the department charged.

The department's complaint also argued that lucrative compensation contracts given four of the company's top officials during the takeover — all of whom served on the administrative committee — swayed their decision affecting the retirement plan.

The government now wants the officials, Graniteville and Southeastern to pay the plan the unpaid $27 million in principal and interest.

Graniteville officials declined to comment on the litigation.

The suit is the second brought by the government in recent weeks relating to corporate actions affecting pension plans terminated so the corporate sponsor could recapture surplus assets.

The first was filed March 13 against the trustees of the Los Angeles-based Ed Simon Ltd. pension plan for retroactively amending the terminated plan to recover some $892,000 in surplus assets, despite warnings by the Pension Benefit Guaranty Corp. that such an action would be illegal (*Pensions & Investment Age*, March 31).

David M. Walker, deputy assistant secretary for Pension and Welfare Benefit Administration, said the Graniteville litigation reinforces that plan fiduciaries must enforce contractual agreements affecting plan assets. That the case involves a terminated plan is incidental, he said.

The suit was filed April 14 in U.S. District Court in Aiken.

The history of the litigation is complex. In an April 1983 effort to maintain control of the company, Graniteville's board sought to terminate its overfunded pension plans for salaried and hourly employees, and place the estimated $25 million to $30 million in surplus assets in a newly formed ESOP.

The board "irrevocably committed and dedicated to the plan an amount equal to the surplus assets," the department claimed.

Appointed to administer the plan were Robert Timmerman, the company's then-president and chief executive officer; Samuel Swint and Jerry Johnson, executive vice presidents; John Cunningham, treasurer; and William Johnson and Carl Littlejohn, whose titles were not listed. Two

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AT&T acts on South Africa

By Barry B. Burr

American Telephone & Telegraph Co.'s plan to set up a South Africa-free investment option in its $4.3 billion savings plan could lead other companies to offer similar choices.

But a Securities and Exchange Commission ruling that AT&T's proxy statements did not have to include a proposal calling for divestiture from the AT&T pension fund may help corporations resist calls for divestiture from defined benefit plans.

The SEC, in its ruling, informed AT&T that to divest its $40 billion pension fund of South Africa-related securities would put it in jeopardy of violating the Employee Retirement Income Security Act.

AT&T is believed to be the second corporate sponsor to provide a South Africa-free equity investment option for its employee savings plan. Lotus Development Corp., Cambridge, Mass., adopted a South Africa-related investment policy last year, shortly after starting its employee benefit plans (*Pensions & Investment Age*, Aug. 5).

AT&T was responding to a wide range of South Africa-related demands by a group of five employees, led by Mel Robin, a research scientist at AT&T Bell Laboratories in Murray Hill, N.J., said Walter G. Murphy, AT&T's director of corporate information.

A separate employee group, the Alliance of Black Telecommunications Employees, led by Alex Tillman, also of Bell Laboratories, had sought a shareholders' vote on restricting the investments of the defined benefit plan, Mr. Murphy said.

Cecilia D. Blye, SEC special counsel, supported AT&T's position that a matter involving the pension fund was inappropriate for shareholder consideration.

"The proposal may be omitted from the company's proxy material under rule 14a-8(c)(2), because it would require the company as fiduciary of the pension fund to take steps which would place the fiduciary in jeopardy of breaching its obligation under ERISA," said Mr. Murphy, quoting Ms. Blye's letter in response to AT&T's inquiry.

Neither Ms. Blye nor officials of the Department of Labor, which oversees ERISA compliance, could be reached for comment.

ERISA requires funds to invest their assets solely with regard to return and risk objectives, rather than political goals. No company

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Misrepresentation alleged

SEC suing manager

By Chuck Paustian

WASHINGTON — The Securities and Exchange Commission has filed a civil suit charging Mark E. Spangler and his Boston money management firm, The Spangler Group, with misrepresenting information to investors.

The SEC's action is seen by some as a possible warning to the investment management profession to step up its self-policing activities, or face government intervention.

Consultants, investment managers and pension executives said the suit will help to focus the industry's attention on performance measurement, although they all added most money managers present performance results in a legitimate manner.

Mr. Spangler is president of The Spangler Group, which actively manages about $25 million, according to the SEC; it was not known how much was tax exempt.

He was charged with misleading investors regarding the firm's investment performance, forging an opinion letter from the accounting firm of Arthur Young & Co. verifying the performance results and misrepresenting his educational and professional background.

"The commission is seeking a permanent injunction and whatever other equitable relief the courts deem appropriate," said Harry Weiss, branch chief, division of enforcement of the SEC.

Mr. Weiss said the SEC's complaint is a civil action. He would not say what caused the commission to begin the investigation.

The SEC received a temporary restraining order, issued April 11, enjoining Mr. Spangler and The Spangler Group from holding, controlling or possessing the funds or securities of the firm's clients and from withdrawing funds or securities from any client account prior to April 16.

Mr. Weiss said the restraining order has been extended, through mutual agreement of both parties, until April 30. An independent auditor, to be named by both parties, also was appointed, he said.

He added investors are not affected by the restraining order and are free to remove any of their assets from The Spangler Group.

Mr. Spangler could not be reached for comment. His attorney — Paul G. Roberts, partner in the Boston law firm of Forman, Roberts, Klickstein & Levy — said he was not aware of any clients removing assets.

"My client will respond in due course to the charges in court," he added.

The pension community reacted to the suit with more apprehension than surprise, fearing increased government involvement in the investment management industry.

"To me, it's very much suspicions confirmed," said Roger C. Bransford, managing director of William M. Mercer-Meidinger Asset Planning Inc., Atlanta.

"I was not surprised to see it. I

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Bill of rights now necessary

THE SHAREHOLDER bill of rights developed by the Council of Institutional Investors is long overdue.

Such a bill of rights may have been unnecessary when the top managers of companies also were major shareholders in the companies. In such cases, the interests of management and shareholders were unlikely to diverge significantly.

Today, however, when top management often owns only a minuscule amount of a company's stock, the interests of managers and shareholders can be at odds.

Indeed, management may sometimes entrench itself at shareholders' expense. Management may fight a takeover bid that would be in the long-term interests of the shareholders, for example. It may pay "greenmail" to a corporate raider to protect its own interests. As Edward S. Hadas, an analyst at David L. Babson & Co. Inc. has pointed out, "the prevalence of million-dollar salaries and lucrative 'golden parachutes' does nothing to enhance trust in management selflessness."

Shareholders should not be left with only one recourse — the sale of the stock — in such situations. They should have the right to vote on such issues as greenmail, poison pills and golden parachutes — matters that ultimately may affect the financial health of the company.

The shareholders' bill of rights would give them this right and several others. Unfortunately, the shareholders' bill of rights is not a law or even a regulation. It is a prescription, with little to back it up.

The Council of Institutional Investors and others who support the bill of rights should publicize it so shareholders, both individual and institutional, can become aware of it.

If shareholders feel the need of such a bill of rights to reinforce their interests, they will clamor for recognition and adoption of it by corporations, much as corporations adopted the Sullivan Principles of behavior in South Africa.

Corporate managements that truly believe they always act in the interests of shareholders should have no reluctance to recognize and abide by this bill of rights.

VERY WELL, GENTLEMEN... IT IS DONE!!! NOW..... WHO WANTS TO BE THE FIRST PERSON TO SIGN?!
SHAREHOLDER BILL OF RIGHTS
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FASB panel's role needs defining

WHETHER OR NOT the Financial Accounting Standards Board staff that developed the new pension reporting standards ignored the task force that was supposed to help it in its efforts, it apparently has much to learn about the care and feeding of such task forces.

Several of the task force members believe their deliberations were merely window dressing, as reported in the April 14 issue of *Pensions & Investment Age*. They left the task force convinced that not only were their concerns and suggestions ignored, but also that the FASB staff never had any intention of listening to them.

To avoid similar situations, the FASB must make it clear to those invited to serve on its task forces exactly what role they are expected to play.

It should define the responsibilities of the task force, how often it is expected to meet, what input it is expected to give, and how much weight will be given to that input.

At least then, task force members can decide whether their participation is likely to have sufficient impact to make it worthwhile given the time and effort necessary to become familiar with the intricacies of the proposed standards.

Failing this, the FASB may find itself again faced with noisily dissenting task force members who believe their time has been wasted.

Letters to the editor

High-risk tag rebuttal

To the Editor: Alan Krauss' March 31 article on "vulture funds" does a great disservice to your readers.

It creates the impression that all pension fund vehicles that invest in distressed properties are high risk, speculative entities, run by fund managers who are dependent on improving market cycles to achieve investment goals.

To the contrary, there are managers who are highly experienced — indeed specialized — investors in distressed and bankrupt properties. At American Continental Properties Group we have successfully focused most of our energies on such projects since our founding in 1978. Our pension fund subsidiary — ACP Advisors, Inc. — now offers the benefit of that experience to pension fund managers.

Even in the best of times, there are always turnaround opportunities with distressed real estate. Given the current nature of the real estate market, pension fund investments in turnaround commingled oriented commingled pools represent good market strategy.

And contrary to what your article stated, these investments are not necessarily for a long-range time horizon. Adding value to distressed real estate can result in significant gains in a relatively short time frame of three to five years.

On the other hand, those that count on an improving market cycle to bring about a capital gain may be waiting a long time indeed.

Daniele D. Bodini
President
American Continental
Properties
New York

Fund on wrong list

To the Editor: The 1985 PIPER performance report in the Feb. 17 issue miscategorizes our Lincoln National, Indiana, special opportunity fund results. The page 21 list of top equity funds grouped by size (one-year returns) inserts LNC's 1985 performance of 44.1% in the "under $10 million" category. The fund during 1985 varied between $15 million and $25 million in market value, so should be ranked instead as the top-performing fund nationally in its proper size universe.

Of note, MPT Associates, an investment affiliate of Lincoln, also manages a second special fund of approximately $40 million for LNC using our same basic MPT quantitative/judgmental disciplined investment approach. Its 1985 results lagged the aforementioned fund by only 3.1%, which would rank it third nationally in the same category.

Charles M. Kulp
Vice president,
portfolio manager
MPT Associates
Investment Management
New York

Pensions & Investment Age welcomes letters to the editor.

Letters should include the name, address and, when appropriate, company of the writer.

The editors of *P&I Age* reserve the right to condense any letter.

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Cash Management

Strong market weakens ploy

Managers find new methods of dividend capture

By Richard J. Gillespie

NEW YORK — The bull market of the past 12 months has threatened the viability of a once booming cash management technique — dividend capture.

Although complex, variations of dividend capture have offered returns of sometimes two to three times the after-tax return on Treasury bills.

As a result, dividend capture has mushroomed into a billion-dollar market in the past few years, analysts say.

But as stock prices have risen dramatically during the past 12 months, dividend yields on stocks have fallen to about 3.5% from between 6% and 7%. The low yields have begun to threaten the viability of traditional dividend capture while spawning variants that minimize the use of the dividend and create value in other ways.

Using the technique, a corporate cash manager benefits from the 85% dividend tax exclusion by buying stocks to capture the dividends and then selling them immediately.

At the same time, a corporate cash manager will use options on the stock to capture the premium or to hedge the position, and sometimes also hedge the stock with the purchase of a stock index future (to protect the cash investment from capital fluctuations).

"When we first went into this, the market was pretty lucrative, you could get 12% and 14% after-tax returns," said Gil Coblentz, director of finance at C.B. Fleet Co., Lynchburg, Va., a health and beauty aids concern that had total revenue of about $70 million in 1985.

Last year, the dividend capture program bettered the corporation's municipal investments by 250 basis points, and its Treasury bills by 300 basis points, on an after tax-basis, Mr. Coblentz said.

As dividend capture caught on, and the market became more competitive, however, returns have not been as spectacular, he noted. The recent interest rate drop has taken a lot of the premium out of the options side of the program because options premiums contain an interest rate-sensitive component, he said.

Now that yields on stocks are also down, the dividend capture program, like the company's other corporate cash investments, will be coming under pressure, he said.

The result is that Mr. Coblentz anticipates the returns from the dividend capture program, which comprises about one-third of the company's $14 million to $18 million cash, will be lower this year, perhaps by as much as one or two percentage points on an after-tax basis.

But lower yields are simply the latest in a long line of setbacks that dividend capture managers have had to face, even while the growth of assets under management has been extraordinary.

It was because of the phenomenal growth that the managers ran into trouble: It created too many players who began bidding up the prices of stocks before dividend dates.

Earlier, in 1984, dividend capture managers had to find ways around the Deficit Reduction Act, which imposed new requirements on tax-advan-

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Theodore Mertz, senior vice president-cash management, left, and Sylvester Florian, wire transfer product manager at Mellon Bank.

Banks correct kinks in overdraft system

By Chuck Paustian

After a shaky first couple of weeks, banks seem to have worked out the kinks of the Federal Reserve Bank's intraday overdraft monitoring system.

The Fed's program, which began March 27, has caused some minor headaches for a few banks and their corporate clients, mainly in the form of delayed wire transfer payments.

Banks, including Mellon Bank, Pittsburgh, and Bank of Oklahoma, Tulsa, have responded by implementing steps to minimize the impact of these mishaps and to eventually eliminate them.

The cash managers of two companies that have experienced some problems with the monitoring system — Allegheny International Inc., Pittsburgh, and Quaker State Oil Refining Corp., Oil City, Pa. — said the effects of the delays were insignificant and they do not expect similar occurrences.

Under the Federal Reserve's monitoring program, a bank would not be allowed to transfer any funds over the wire network if the bank had reached its overdraft limit. The bank would be allowed to continue its wire transfer activity once it had received sufficient funds from other banks.

Corporate cash managers and bank executives had feared the new system would severely limit their abilities to make timely wire transfer payments. In addition, if enough banks were prohibited from making wire payments, some feared a domino effect, causing a gridlock of the entire wire transfer network (*Pensions & Investment Age*, Nov. 25).

Although the fears of most executives have yet to be realized, there were a few hitches under the new monitoring program.

Deborah DiLorenzo, administrator of cash management at Allegheny, said the company had a few wire transfers held by Mellon for a short period during the first weeks after the system was in place.

"It was just a case of miscommunication between the account officer and the wire room," said Ms. DiLorenzo. "They were only held for a short period of time until the account officer approved it."

She said the delay did not have any major impact on the company because the amount of the transfer was "only a couple hundred thousand" and the delay was only for about 10 minutes.

She also said there have been no problems involving wire transfers since those early instances.

On average, Allegheny initiates about $20 million in wire transfers each day.

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Cash notes

Interest rules eyed

WASHINGTON — The Treasury Department is proposing to introduce "straightforward" rules for transferring interest on book-entry Treasury securities.

The rules would apply only to securities in the Treasury/Reserve Automated Debit Entry System, a commercial book-entry system.

The deadline for comments on the proposals is May 13.

The Treasury is proposing to use the automated clearinghouse, a low-cost electronic payment processor operated among banks, to pay interest to bond and note holders.

In a move that will phase out paper securities, the U.S. Treasury will make all new Treasury bonds and notes book-entry securities beginning July 1.

As part of the change, it will also introduce a new Treasury Direct Access Book Entry System (Treasury Direct) based on rules proposed last December.

Intraday statements

CHICAGO — First National Bank of Chicago introduced an intraday statement report, which a spokesman claims is the only product available to provide on-line, real-time balance and detailed transaction data in a single report.

Called FirstCash Intraday Statement Report, it takes the previous day's ending balance and rolls over the float to provide the treasurer with the current balance information at the start of each day.

Each time a debit or credit is processed through an account, the information is transmitted

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Payden & Rygel index of short maturity assets*

(for month ended March 31)

	March 1986	Quarter ended 3/31/86	Year to date	12 months ended 3/31/86	Yield level monthly change[a]
	Unannualized total returns				
90-day					
U.S. Treasury bill	0.7287	1.9239	1.9239	8.1636	−68
Domestic CD	0.7272	2.0358	2.0358	8.5777	−45
Euro $ CD	0.7311	2.0508	2.0508	8.7352	−43
180-day					
U.S. Treasury bill	0.9387	2.1939	2.1939	9.1968	−73
Domestic CD	0.8336	2.1516	2.1516	9.1559	−47
Euro $ CD	0.8241	2.1554	2.1554	9.3402	−43
1-year					
U.S. Treasury note	1.2521	2.6482	2.6482	10.9733	−71
2-year					
U.S. Treasury note	2.0503	3.8573	3.8573	15.9411	−79

*Figures are unannualized total returns. Year-to-date and 12-month figures linked monthly. 90- and 180-day Treasury bill yield level changes on discount basis.

[a]Basis points.

Source: Payden & Rygel, Los Angeles

The Payden & Rygel index of short maturity assets is a regular feature of the cash management section. It represents total returns on money market instruments, rather than simple yields. It is intended to provide a benchmark for judging performance on short-term assets.

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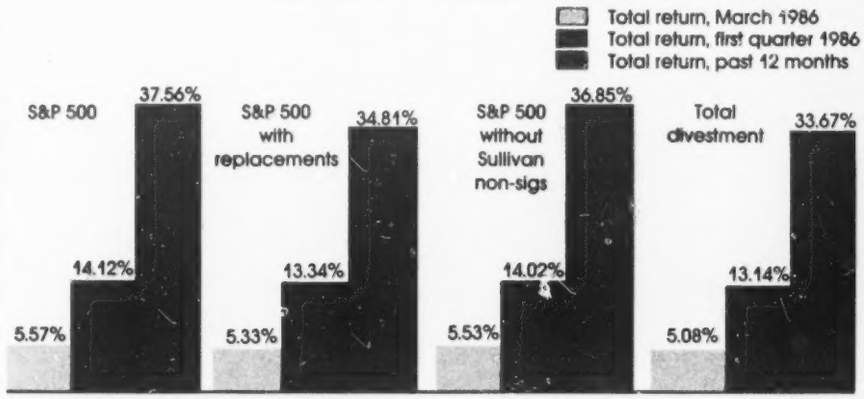
Statistically speaking

The Statistically Speaking page offers an at-a-glance look at statistics for the latest quarter.

The Wilshire South Africa Free Index, Mercer-Meidinger bullet GIC data, First Chicago's MMI and the Russell 3000 returns will appear regularly.

Other data will be used as time and space allow.

South Africa Free Index



Source: Wilshire Associates, Santa Monica, Calif.

S&P 500 with replacements: replaces a South Africa-related company with next largest company in the industry. **S&P 500 without Sullivan non-signatories**: excludes 20 companies, no replacements. **Total divestment**: eliminates all companies with South Africa involvement, no replacements.

Multiple Markets Index

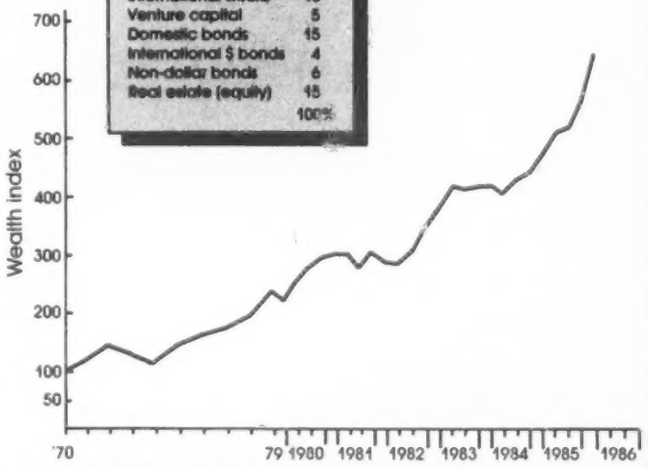
12/31/69 = 100 Data through 3/31/86

1970 through 1979 data reflect year-end figure

The Multiple Markets Index is a benchmark for total portfolio returns. It is composed of nine asset classes used by retirement plan executives; it is calibrated to reflect the same degree of risk of the typical pension portfolio; it uses passive fixed policy weights; and it represents the individual asset classes by the broadest and most complete market return data available.

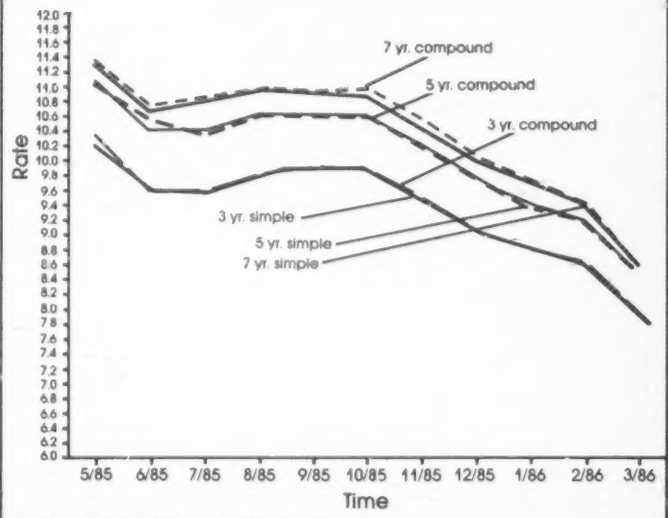
	Weights
Large cap stocks	30%
Small cap stocks	15
International stocks	10
Venture capital	5
Domestic bonds	15
International $ bonds	4
Non-dollar bonds	6
Real estate (equity)	15
	100%

Five-year annualized return	16.8%
One-year return	36.1%
Latest quarter	13.1%



Source: First National Bank of Chicago Investment Management Group

William M. Mercer-Meidinger Inc. Summary of average bullet GIC data compound and simple rates



Source: William M. Mercer-Meidinger Inc., Louisville, Ky.

First quarter 1986 returns

	Russell 3000	Russell 1000	Russell 1000 by market capitalization				Russell 2000
			Large	Medium/large	Medium	Medium/small	
Financial services	21.0%	21.5%	29.0%	22.0%	21.6%	17.6%	15.2%
Utilities	17.1	17.1	15.9	17.5	17.4	20.4	15.5
Technology	3.5	2.9	0.5	7.2	7.4	2.8	8.3
Basic industry	19.7	20.1	19.1	22.2	19.6	18.4	17.4
Integrated oils	−3.7	−3.7	−3.1	−12.5	7.6	4.5	NA
Other energy	−8.1	−8.4	NA	−18.2	−4.9	−2.0	−6.0
Consumer staples	21.1	21.3	23.7	19.4	21.9	18.4	16.7
Consumer discretionary	17.9	18.1	17.3	19.8	17.1	17.8	16.3
Health care	23.1	23.6	22.8	21.2	41.5	24.6	18.5
Auto and transportation	22.3	22.1	30.6	18.6	16.2	23.7	25.8
Total	14.7	14.8	11.7	16.5	16.7	15.9	14.2

Source: Frank Russell Co., Tacoma, Wash.